United States Court of Appeals

for the

District of Columbia Circuit

TRANSCRIPT OF RECORD

BRIEF FOR PETITIONER

IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

[redacted] 272

No. 19,269

NORTH CENTRAL AIRLINES, INC., *Petitioner*

v.

CIVIL AERONAUTICS BOARD, *Respondent*

On Petition for Judicial Review of an Order of the Civil Aeronautics Board

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STATEMENT OF QUESTIONS PRESENTED

1. Whether Respondent's Order directing Petitioner to refund subsidy in the amount of its 1962 investment tax credit was unlawful in view of the provisions and purposes of section 38(a) of the Internal Revenue Code of 1954 and section 203(e) of the Revenue Act of 1964, and Respondent's underlying subsidy rate order.

2. Whether Petitioner is barred from challenging Respondent's order because of its failure to object to the underlying subsidy rate order or the benefits thereunder.

3. Whether this Court has jurisdiction in view of *Mohawk Airlines, Inc.* v. *C.A.B.*, 117 U.S. App. D.C. 326, 329 F. 2d 894 (1964).

INDEX

CITATIONS

CASES:

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BRIEF FOR PETITIONER

JURISDICTIONAL STATEMENT

Petitioner is an air carrier holding certificates of public convenience and necessity issued by Respondent authorizing it to engage in interstate and foreign air transportation as those terms are defined in the Federal Aviation Act of 1958, as amended.

Petitioner seeks review of an Order of Respondent, Order No. E-21663, issued January 11, 1965, in which Respondent directed the refund of certain subsidy funds received by Petitioner.

The jurisdiction of this Court is invoked under section 1006 of the Federal Aviation Act of 1958, 72 Stat. 795, 49 U.S.C. 1486, and section 10 of the Administrative Procedure Act, 60 Stat. 243, 5 U.S.C. 1009.

STATEMENT OF THE CASE

Order E-21663, of which review is here sought, purports to determine the amount of money refundable by Petitioner to Respondent for the calendar year 1962 pursuant to the "profit sharing" provisions of the *Local Service Class Subsidy Rate*, 34 C.A.B. 247 (1961).

The *Local Service Class Subsidy Rate* was promulgated by the Respondent in a statement of provisional findings and conclusions and order to show cause adopted February 16, 1961 (34 C.A.B. at 428). Petitioner did not file objections to the proposed rate, and by Order E-16485, March 7, 1961, (34 C.A.B. at 418) the rate was made final as to Petitioner and eight other local service airlines.[1] The rate was made effective for an indefinite period beginning January 1, 1961.

Subsidy is paid by Respondent pursuant to rates established pursuant to section 406(b) of the Federal Aviation Act of 1958, 72 Stat. 763, 49 U.S.C. 1376 in payment for:

> "the transportation of mail by aircraft, the facilities used and useful therefor and the services connected therewith . . ." (Local Service Class Subsidy Rate, 34 C.A.B. at 443.)

However, section 406(b) of that Act provides that, in fixing such rates, Respondent shall take into account the

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[1] Ultimately the rate was accepted by all 13 local service airlines.

"need" of each carrier. The portion of the rate attributable to "need" (the subsidy portion) is paid by Respondent pursuant to section 406(c) of the Federal Aviation Act.[2]

Amounts fixed pursuant to the "need" clause are designed to make up a carrier's losses, if incurred under honest, economical and efficient management, and to provide enough for a reasonable return on investment after payment of taxes.[4]

The promulgation of the *Local Service Class Subsidy Rate* marked an acknowledged "radical departure" by Respondent from the previous method of establishing subsidy.[5] Prior to 1961, subsidy rates were established by the

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2 Section 406(b) provides as follows:

"In determining the rate in each case, the Board shall take into consideration, among other factors, (1) the condition that such air carriers may hold and operate under certificates authorizing the carriage of mail only by providing necessary and adequate facilities and service for the transportation of mail; (2) such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law; and (3) *the need of each such air carrier (other than a supplemental air carrier) for compensation for the transportation of mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense.*" (Emphasis added.)

3 Section 406(c) was added in the revision and re-enactment of the Civil Aeronautics Act of 1938 into the Federal Aviation Act of 1958. The separation of responsibility for paying the "need" element from the "service mail pay" was originally accomplished in 1953 by Reorganization Plan # 10, 67 Stat. 644, 5 U.S.C. 133z.

4 Carriers which now receive subsidy include, principally, all 13 local service airlines, as well as those serving Alaska or Hawaii exclusively. The 13 trunkline carriers, with the exception of Northeast Airlines, have been found by Respondent to no longer require subsidy.

5 "The proposed class rate represents a radical departure from the methods ordinarily used by the Board to fix subsidy rates. Hitherto the Board has typically determined rates for each carrier either for a past period or for a prospective future period on the basis of an analysis of the particular carrier's own operating results and forecasts. The proposed class rate,

Respondent on a carrier by carrier basis. In the Class Rate Order Respondent found that the 13 local service carriers were a sufficiently homogenous "class" to justify the application of a single formula rate to all.[6] In order to guard against the possibility that the subsidy formula would produce unreasonably high earnings, Respondent included a profit sharing feature in the rate. Determination of the amount of the profits to be shared was provided for by a percentage formula[7] to be applied to profits calculated on the basis of revenues, expenses, investment and taxes as defined by the order.

Under the class rate Petitioner earned a gross subsidy of $8,842,000 for calendar year 1962 before profit sharing. On

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while constructed on the basis of each individual carrier's need, is nevertheless a rate which is stated in terms of a class of carriers. While the amounts payable to any given carrier will vary in accordance with the rate formula depending upon volume of service, equipment utilized, and density of operations, the same formula will be applicable to all carriers in the group. . . ." 34 C.A.B. at 429.

[6] The class rate does not produce the same compensation for each carrier. The formula is devised so as to provide a different amount of subsidy for each seat mile flown depending upon the traffic density, length of hop, and other features of a carrier's operations which are assumed to bear a relationship to its subsidy need.

In subsequent revisions of the class rate order various aspects of the formula have been modified in an effort to obtain a closer correlation between the need of each carrier and the subsidy produced by the formula.

[7] The formula provided:

"B. In any case where a carrier's annual earnings (after applicable income taxes) exceed its fair and reasonable differentiated rate of return, such carrier shall refund a portion of such profits to the extent indicated in the table below to the Board as subsidy not due the carrier:

Rate of return after taxes (percent)	Percentage of profits refunded by carrier
0 to D[1]	0
D to 15	50
Over 15	75

[1] D represents the fair and reasonable differentiated rate of return for each carrier as defined in IIA above." 34 C.A.B. at 421-22.

March 22, 1963, Petitioner, as required, submitted its calculation of profit sharing for 1962 (Form T-88) (J.A. 99). This calculation showed that an amount of $309,011 was required as a profit sharing refund. On October 28, 1964, Respondent's staff advised Petitioner that its own computations tentatively indicated that the profit sharing refund should be $601,539 (J.A. 177 *et seq.*)

Among the several profit sharing items as to which Petitioner and the Staff were in disagreement, only one is at issue in this appeal: an amount of $25,660 representing an investment tax credit taken by Petitioner pursuant to Section 38 of the Internal Revenue Code of 1954, 68A Stat. 16, 26 U.S.C. 38, Appendix A(3) (See Tax return, J.A. 155, line 32(c)).[8]

Respondent's staff took the position that the provisions of the Class Rate Order entitled Respondent to reduce subsidy by the amount of the credit.[9]

By letter of November 20, 1964, Petitioner advised Respondent's staff of its objections to the proposed profit

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[8] Section 38 provides for a credit against tax of the amount determined under the provisions of section 46 of the 1954 Internal Revenue Code. Section 46 (Revenue Act of 1964, 78 Stat. 19) provides, with certain limitations, for a credit amounting to 7% of any "qualified investment". Petitioner earned its tax credit in 1962 by virtue of purchase of various items of ground equipment and improvements to aircraft.

[9] The Class Rate Order is set forth in Appendix C. Section III of the order, on which Respondent relied, states in part as follows:

> "In applying the [profit sharing] provisions of II above, the revenues and other income items, expenses, investments, and income taxes shall be determined in accordance with the provisions of this section III.
>
> * * * *
>
> "F. Income taxes.—Federal and State income taxes shall be determined on the basis of the carrier's income tax returns for each year as submitted to the taxing authorities, with such amendments or revisions (including tax carryback and carry-forward credits) as may have been filed as of the date of the final determination of excess profits (or an earning deficiency) under this order; . . ." (34 C.A.B. 422, 426).

sharing calculation.[10] These objections were also voiced in a subsequent meeting of representatives of Petitioner and Respondent's staff, and were spelled out in greater detail in a letter of December 2, 1964, from Petitioner's counsel to the staff (J.A. 238-262). Petitioner's position was that, under section 38 of the 1954 Internal Revenue Code, and section 203(e) of the Revenue Act of 1964, Respondent was not authorized to reduce the Petitioner's income taxes by the amount of the credit for the purpose of establishing the profits to be shared with the government. Despite these objections,[11] Respondent proceeded to issue the order of which review is sought (Appendix B), providing for the profit sharing refund of $556,103, including $25,660 attributable to the tax credit.[12] Subsequently, on February 10, 1965, Respondent, without agreement of Petitioner (J.A. 285), deducted from amounts due to Petitioner

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[10] "On Schedule R, you proposed a reduction in the tax computation to allow for investment credit of $25,660.

"We are of the opinion that this is not in accordance with the intent of Congress; it is contrary to law and we cannot, therefore, accept the finding proposed in your letter." (J.A. 233).

[11] No hearing procedure is available under Respondent's rules for those carriers contesting profit sharing determinations. Petitioner, in connection with its 1961 profit sharing determination, had requested a hearing on disputed matters. In response thereto, Respondent stated:

". . . With regard to certain adjustments specified in the instant order, North Central has informally requested a hearing. Aside from the procedural deficiencies of such a request, it is sufficient to point out, as we have done before (Order E-20253, December 11, 1963), that the administration of the profit-sharing provisions of Order E-16485 does not involve rate-making determinations, which require opportunity for hearing and other formal procedures. Moreover, the carrier has had ample opportunity to make its contentions and support therefor to the staff and, by informal memorandum, to the Board, and we have fully considered all of the matters advanced by the carrier. Accordingly, the carrier's informal request for a hearing is denied." (Order E-21319, Sept. 23, 1964, p. 2).

[12] Certain adjustments not pertinent here were made in the course of negotiations between the Respondent's staff and Petitioner. These resulted in a reduction of the claimed profit sharing from $601,539 to $556,103. None of these adjustments involved the tax credit.

for subsidy in 1964, the 1962 profit sharing refund fixed by Order E-21663 (J.A. 280).[13]

On March 9, 1965 a timely petition for judicial review of Order E-21663 was filed by Petitioner.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954, 68A Stat. 16, 26 U.S.C. 38, the Revenue Act of 1964, 78 Stat. 19, Federal Aviation Act of 1958, 72 Stat. 795, 49 U.S.C. 1486, and the Administrative Procedure Act, 60 Stat. 243, 5 U.S.C. 1009, are set forth in the appendix hereto.

STATEMENT OF POINTS

1. Respondent's order, insofar as it required reduction in subsidy by the amount of the investment tax credit, is contrary to the provisions of section 38 of the Internal Revenue Code, section 203(e) of the Revenue Act of 1964, and the provisions of Respondent's Class Rate Order governing subsidy payable to Petitioner for the period.
2. Petitioner is not barred by its consent to the Class Rate Order from bringing this action.
3. This Court has jurisdiction over this action.

SUMMARY OF ARGUMENT

I.

Respondent was prohibited by law from reducing the subsidy payable to Petitioner for 1962 by the amount of Petitioner's investment tax credit that year. It was Congress' intention in providing the tax credit in 1962 that no regulatory agency reduce a taxpayer's income taxes

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[13] The actual deduction amounted to $242,291. The balance of the $556,103 had been withheld previously pursuant to a preliminary estimate of the profit sharing refund.

by the amount of the credit "for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method". (Section 203(e) of the Revenue Act of 1964, 78 Stat. 19.)

Respondent's view that section 203(e) does not apply to subsidy rates is without merit. The broad language of section 203(e) and the tenor of its legislative history establishes that Congress intended that the tax credit should be enjoyed by *all* industries, regulated and nonregulated, and that federal agencies were forbidden to negate the benefit of the credit by rate or accounting regulation.

The alleged incompatibility of section 203(e) with Respondent's subsidy rate practices does not justify Respondent excusing itself from compliance with that section. The legislative history makes it clear that Congress specifically intended to override existing regulatory practice where in conflict with section 203(e). Under the circumstances Congress was not obliged to make specific reference to subsidy rates in order to obtain the compliance of Respondent.

Other reasons given by Respondent for refusing to comply with section 203(e) are insufficient.

a) Section 406(b) of the Federal Aviation Act, under which subsidy rates are established, is not a substitute for section 203(e). The statutory objectives are patently different, and experience shows that the application of section 406(b) has not tended to encourage the type of equipment modernization sought by the investment tax credit.

The substitution of section 406(b) for the tax credit would create inequities Congress intended to avoid. The well-to-do nonsubsidized carriers would keep the tax credit while weaker subsidized carriers would be denied it. Petitioner would be deprived of the tax advantages enjoyed by its airline and surface carrier competitors. The desire

to avoid such competitive inequity was the principal reason Congress enacted section 203(e).

b) There is no basis for Respondent's contention that Congress intended to limit application of section 203(e) to "commercial" rates as distinguished from "subsidy" rates. The broad purposes of section 203(e) allow no room for such distinctions. Section 406(b) is similar to other public utility rate provisions, as this Court and the Supreme Court have observed. A subsidy rate is still, strictly speaking, a "mail rate" and service must also be provided in order to obtain the subsidy.

If Respondent's theory is correct, many other federally subsidized companies may also be ineligible to retain the tax credit. This singling out of particular industries as ineligible to retain the credit is precisely what section 203(e) is designed to prevent.

Because of the way subsidy is determined, Respondent's refusal to permit retention of the tax credit in subsidy determinations would also deny the benefit of the credit in fixing commercial rates for subsidized carriers. Thus the purported distinction between subsidy rates and commercial rates is in reality a distinction between subsidized airlines and nonsubsidized airlines—a distinction Congress never envisioned.

c) Section 203(e) is not a retroactive amendment by Congress of a subsidy rate applying to Petitioner. Although Congress had every right to act retroactively, it was unnecessary because the Class Rate Order leaves open the precise taxes to be recognized in determining profit sharing. This depends on the earnings of the carrier and the tax laws applicable for the period involved.

The applicable tax laws provided for the investment credit; *but* they also precluded the taking of the credit by Respondent. Respondent took the credit but ignored the prohibition. In so doing, it violated not only the tax laws but the Class Rate Order.

II.

Petitioner is not barred from bringing this action by its acceptance of the Class Rate Order. The rate order makes no provision for investment tax credits, which did not exist at the time the rate was accepted by Petitioner. Petitioner's consent to the rate was only a consent to use applicable taxes in determining any subsidy refund. By virtue of section 203(e), the tax credit is not applicable.

Nor has Petitioner otherwise "consented" to the taking of the tax credit within the meaning of section 203(e). Obviously, such consent could not have been granted in advance of the enactment of the credit. Since then, Petitioner has resisted Respondent's taking of the credit by all reasonable means.

III.

This Court has jurisdiction over this appeal. The appeal is from a final order of the Civil Aeronautics Board and falls squarely within the terms of section 1006(a) of the Federal Aviation Act. The recent decision of this Court in *Mohawk Airlines* v. *C.A.B.*, 117 U.S. App. D.C. 326, 329 F. 2d 894 (1964), wherein this Court declined jurisdiction, is not controlling. The appeal therein was taken from a letter of Respondent advising of its intent to offset certain amounts allegedly due it against future subsidy payments. The letter imposed no obligation upon Mohawk. The instant case involves, not a letter of intention, but a formal order imposing an enforceable legal obligation.

ARGUMENT

I. RESPONDENT UNLAWFULLY ORDERED THE INVESTMENT TAX CREDIT OFFSET AGAINST SUBSIDY PAYABLE TO PETITIONER FOR 1962.

Under Section 38 of the Internal Revenue Code of 1954, 68A Stat 16, U.S.C.A Title 26, enacted in 1962, petitioner earned 7% credit, amounting to $25,660, against corporate income tax payable for 1962. In the Revenue Act of 1964, section 203(e) 78 Stat. 19, Congress provided as follows:

> "TREATMENT OF INVESTMENT CREDIT BY FEDERAL REGULATORY AGENCIES.—It was the intent of the Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in basis required by section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use—
>
> (1) in the case of public utility property (as defined in section 46(c)(3)(B) of the Internal Revenue Code of 1954), more than a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed) of the credit against tax allowed for any taxable year by section 38 of such Code, or
>
> (2) in the case of any other property, any credit against tax allowed by section 38 of such Code,
>
> to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similiar result by any other method."

Petitioner maintains that this statutory language applies squarely to Respondent's profit sharing determinations and that Respondent's failure to follow the statute was unlawful.

In its final determination of subsidy due to Petitioner for 1962, Respondent, in the order under review (Appendix B), directed that subsidy owed Petitioner be reduced by, *inter alia*, the amount of the investment tax credit. Four major arguments were made by Respondent in support of its action:

1. Since Congress did not specifically consider subsidy, and since the tax statute and subsidy provisions are incompatible, Respondent need not apply the tax statute.

2. The promotional objectives of the tax statute are already embraced in the subsidy statute and hence the former statute need not be applied.

3. The tax statute was designed only to affect the retention of the credit in "commercial rate" cases.

4. The tax statute would constitute a retroactive amendment of a final rate, and this was not intended by Congress.

None of these arguments have merit, as we show herein.

A. Respondent May Not Imply From Congressional Silence That Subsidy Rates Are Not Intended to be Covered by Section 203(e).

1. The Statutory Language Covers Subsidy Rates.

Section 203(e) of the 1964 Act sets forth in its essentials that:

> "It was the intent of Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954, to provide an incentive for modernization and growth of private industry *(including that portion thereof which is regulated)*. Accordingly, Congress does not intend that *any agency or instrumentality of the United States having jurisdiction with respect to the taxpayer* shall, *without the consent of the taxpayer*, use . . . the credit against tax allowed for any taxable year by section 38 . . . *to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service* of the taxpayer or to accomplish a similar result by any other method." (Emphasis added).

It is evident that Petitioner is a part of regulated industry; that Respondent is an agency of the United States having jurisdiction over Petitioner; and that Respondent has acted without the consent of Petitioner.[14] It is also clear that Respondent has "reduced Petitioner's income taxes for the purpose of establishing the cost of service." Order E-21663 indicates that the reduction was made. The Class Rate Order establishes that the computation of profit sharing is, in essence, a computation of "cost of service". The profits to be shared necessarily depend upon the cost of service.[15]

The statute, moreover, goes further. To avoid agency efforts to subvert the purposes of section 203(e), the final clause prohibits any agency from accomplishing "a similar result by any other method." The "similar result" obviously means denying the taxpayer the benefit of the credit in favor of the ratepayer. "Any other method" means just that. Its broad terms plainly enjoin the carving out of exceptions.

2. The Legislative History Makes It Clear That Congress Intended the Statute to Apply to All Rates, Including Subsidy, and to Modify Existing Law and Policy Where Necessary to Accomplish Its Objective.

(a) *Respondent may not require Congress to specifically mention subsidy as the price of compliance*

Respondent finds in this language that its subsidy determinations were not intended to be covered by section 203(e):

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14 Section II below (p. 41) develops this point in greater detail.

15 "Subsidy has generally been available to make up the difference between revenues and expenses." 34 C.A.B. at 432. A subsidy determination requires a determination of the "cost of service" in order to establish that difference. The class rate does not depart from this concept. Although it was establishing a single formula, Respondent made clear that its formula took cost into account. Thus Respondent concluded:

> ". . . the inclusion of both extremes of costs [high and low] in the class rate formulation will produce a reasonable end result consistent with the need of each carrier under the statutory standard of 'honest, economical and efficient management'." (34 C.A.B. at 436.)

> "We would not read section 203(e) as incompatible with section 406 without a clear statement that the Congress desired such a result, and we have found nothing to indicate that Congress ever considered the consequences of section 203(e) in subsidy ratemaking proceedings." (Order No. E-21663 at p. 5.)

At the outset it should be understood that the incompatibility of the statutes is not inherent. Nothing in Section 406(b) prevents Respondent from finding, upon an appropriate showing, that a carrier has a statutory "need" under Section 406 for the tax credit.

The incompatibility arises because Respondent has asserted a policy, the so-called "actual tax policy", under which it refuses to find that carriers need a greater sum for taxes than actually paid.[16] Conceding *arguendo,* that the Class Rate Order covering Petitioner in 1962 embodied the "actual tax policy"[17] the alleged "incompatibility" is therefore between the tax statutes and a policy which Respondent has discretion to change.[18]

Under Respondent's theory, Congress may not modify one of Respondent's policies without indicating that it has specifically considered the policy and desires to modify it. General language, no matter how inclusive, is not deemed adequate. This position is made clear in an earlier order which Respondent incorporated by reference in the order here under review:

> "To infer that a statute materially alters a fundamental principle of subsidy rate regulation (the actual tax policy in this case), it must clearly appear that

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[16] The case generally cited by the Board for this policy is *Western Airlines and Inland Airlines, Inc., Mail Rate,* 14 C.A.B. 201, 251-255 (1951).

[17] The rate order does not specifically state that it intends to apply the actual tax policy although Respondent contends that such was clearly intended.

[18] The "actual tax policy" whatever its virtues clearly is not required by section 406(b). For many years prior to 1951 Respondent fixed subsidy without any such policy.

> Congress intended such an effect.[22] There is no such clear indication in section 203(e) or its legislative history."

> "[22] See *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 316 F. 2d 659 (D.C. Cir., 1963), cert. den. 375 U.S. 881 (1963)." Order E-21227, pp. 34-35.[19]

Respondent's approach to statutory construction clearly places an impossible burden on Congress. Unless the statute itself, or legislative history, furnish a "clear indication" that Congress envisioned a particular instance of its possible application, that instance is presumed not to be covered.

This Court cannot allow an agency to establish such presumptions. Congress must be free to legislate in general terms, and agencies must not be at liberty to demand specific mention as the price of compliance.[20] If Respondent is entitled to exclude airline subsidy from section 203(e), any regulated industry not covered specifically in the legislative history can be withdrawn from broad coverage of the statute simply by a finding on the part of the agency that it is so different that Congress was obliged to mention it specifically.

(b) *An alleged incompatibility between the tax statute and subsidy policy is in no event a basis for excluding subsidy from coverage.*

Congress recognized the possible incompatibility of the tax credit with existing regulatory policies. It intended, in enacting section 38 and 203(b) to resolve that incompatibility in favor of the tax credit.

[19] *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 115 U.S. App. D.C. 8, 316 F.2d 659 (1963), *cert. den.* 375 U.S. 881 (1963), does not support the proposition for which it is cited by Respondent. The statute there involved contained no clear directive to regulatory agencies such as embodied in Section 203(e). See discussion of *Panhandle* case, *infra*, p. 29.

[20] Under the principle of *expressio unius est exclusio alterius*, Congress could not specifically mention some regulated industries with risking exclusion of others.

This is clearly illustrated by the legislative history. The purpose of the investment tax credit was to provide an incentive to modernize the nation's productive facilities. Thus, in advocating the investment tax credit, the Secretary of the Treasury stated:

> "This matter has top priority in the agenda for tax reform. As chief financial officer of the nation, I do not lightly regard tax abatements on the scale proposed here. I urge this legislation because it will make a real addition to growth consistent with the principles of a free economy; because it will provide substantial help in alleviating our balance-of-payments problem, both by substantially increasing the relative attractiveness of domestic as compared with foreign investment and by helping to improve the competitive position of American industry in markets at home and abroad; and because, far from adding to the forces responsible for alternative recessions and recoveries, it will be of major assistance in strengthening our present recovery and enabling us to attain a higher rate of growth and sustained full employment. Early action will resolve uncertainty or hesitancy and begin at once *a strong and lasting incentive for modernization of the productive facilities of our national economy.*" U. S. Code, Congressional & Administrative News, 87th Cong., 2nd Sess. 1962, Vol. 2, p. 3313. (Emphasis added)

Congress also had modernization in mind when it approved the credit.[21]

Congress was aware, in enacting section 38, that under normal regulatory practice, the benefit of the credit might not be retained by the taxpaying utility but would be required to "flow through" to benefit net income and ulti-

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[21] The Senate Committee Report illustrates Congressional understanding of purposes of the credit:

> "The objective of the investment credit is to *encourage modernization and expansion of the Nation's productive facilities and thereby improve the economic potential of the country*, with a resultant increase in job opportunities and betterment of our competitive position in the world economy." U.S. Code, Congressional & Administrative News, 87th Cong. 2nd Sess. 1962, vol. 2, p. 3314 (Emphasis added).

mately the ratepayer. Concern was expressed at that time that such regulatory action would, for the industries affected, destroy the incentive intended by the investment tax credit. In the debate on section 38, Senator Kerr originally made a statement on the floor of the Senate that the credit was intended to "flow through" to benefit ratepayers. However, he repudiated this statement in reaching agreement in conference, and the Conference Report stated:

> "It is the understanding of the conferees on the part of both the House and the Senate that the purpose of the credit for investment in certain depreciable property, *in the case of both regulated and nonregulated industries,* is to encourage modernization and expansion of the Nation's productive facilities and to improve its economic potential by reducing the net cost of acquiring new equipment, thereby increasing the earnings of the new facilities over their productive lives." (H.R. Rep. No. 2508, 87th Cong., 2nd Sess. 14 (1962). (Emphasis added))

Despite this, a dispute arose before certain regulatory agencies as to the intent of Congress. The first illustration was a letter of December 11, 1962, from the Secretary of the Federal Power Commission advising national gas pipeline companies that they should reflect in their accounts only "actual taxes paid", without reserves for "deferred" or "constructive" taxes—thus indicating that the credit should flow through to income. This determination was obviously significant to rate making, and objections were immediately forthcoming from the industry. Accordingly, in January 1963, the Commission instituted a rule making proceeding on the matter (Doc R-232, January 15, 1963), and meanwhile prescribed a revised interim method of accounting (Order No. 261, January 9, 1963).

The dispute before the Federal Power Commission drew the attention of Congress. In hearings held by the House Interstate and Foreign Commerce Committee in February

1963, the Chairman of the Power Commission was asked to explain the Commission's position. The Chairman of the House Committee (Congressman Harris) made it clear what he believed Congressional intent to have been. After quoting from the Conference Report on Section 38, he went on:

> "Chairman Mills of the Ways and Means Committee in a letter to the Chief Counsel dated November 26th stated in part:
>
> " 'The Investment Incentive Credit, as I understand it, was to be purely for the purpose of encouraging capital investment. This would clearly not be the result if any investment credit had to be passed on to the users by public utilities.'
>
> "Thus we find the clear intent of the Congress to conform with the President's recommendation and to give the 7% investment credit to firms for the purpose of encouraging economic growth. *Nothing was said in the final legislative history to indicate that this tax credit was to be passed on to the consumer.*
>
> "Now there seems to be proceedings down in the Commission—with reference to the present tenant (sic) of the Federal Power Commission, from the questions that have been asked the pipelines, with which you no doubt are familiar, and from a general under standing among the industry and the Commission—preparing to take away 7 percent from the investor in the pipeline companies and pass it on to the consumer. *Now, do you think that taking away the 7 percent from the pipelines could possibly be justified in the view of the obvious Congressional intent as you have outlined it here?"* Hearings before Special Subcommittee on Investigation of House Committee on Interstate and Foreign Commerce, 88th Cong., 1st sess., pp. 150-151 (1963) (Emphasis added)

These remarks are particularly significant in that they came from the Chairman of the substantive legislative committee, not the tax committee.

The Ways and Means Committee also responded to the FPC (and possibly ICC)[22] proceedings. In the summer of 1963 Chairman Mills introduced a bill which would have made clear that the investment credit was not to be passed through to the ratepayer.[23]

Meanwhile, the Federal Communications Commission had under consideration the accounting treatment for the tax credit. On July 31, 1963, the Commission released its views in *Matter of Amendment of Parts 31 and 35,* Doc 14850 (FCC 63-744, 38445). The FCC concluded that Congress intended the benefit of the tax credit to flow through to the ratepayer.[24] The Commission's analysis is strikingly similar to that adopted by Respondent in Order E-21663.

> "7. The comments have dwelt at some length on the so-called legislative intent behind the investment tax credit and many of them have implied that the Commission is precluded by such legislative intent from judging the regulatory principles. We do not agree with this implication. It appears to us on the contrary that *Congress fully intended that the tax legislation here involved should fit into the normal regulatory scheme.* In this connection, analysis of the legislative history in light of the comments referred to is indicated. Under Section 220 of the Communications Act, the Commission is given plenary powers to prescribe accounting procedures for carriers subject to its jurisdiction. It is axiomatic that amendment or repeal of a statute by indirect implication is not favored.

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[22] On February 1, 1963, the Interstate Commerce Commission also had occasion to rule upon the proper accounting treatment of the investment tax credit. It also found that the credit should flow through to income, and that only "actual taxes" should be accounted for. ICC No. 34178 (Text quoted at 110 Cong. Rec. 2046-47) However, in a letter of September 26, 1963, the Commission apparently took the position that "it would not attempt to take the credit back from the carriers". See remarks of Sen. Long, 110 Cong. Rec. 2060-62.

[23] H.R. 7111, 88th Cong. 1st Sess. (1963).

[24] The FCC decision concerned accounting regulations. Such accounting treatment obviously has considerable significance in rate determinations.

> *Georgia* v. *Pennsylvania Railroad Company*, 324 U.S. 439, 456-7; *Swettman* v. *Remington Rand*, 65 F. Supp. 940; 82 C.J.S. § 419. The necessary inference to be drawn from those comments which would preclude the Commissions' judgment of the regulatory treatment to be accorded the tax credit is that Congress intended by the tax statute to amend or repeal that portion of the Communications Act which gives the Commission authority to prescribe accounting methods. Aside from the fact that there was no such express statement either in the statutory enactment itself or the record of the legislative proceedings leading up to such enactment, there are several clear indications in the legislations and its history leading to a contrary conclusion." Report and Order FCC 63-744, 38445 adopted July 29, 1963. (Emphasis added)

The Commission went on to give additional reasons why it believed:

> "Congress intended the tax credit to be *compatible with, and not in derogation of*, the existing regulatory scheme. . ." (Ibid) (Emphasis added)

Six months later the Federal Power Commission issued its decision in the rule making proceeding. By a 3-2 margin the Commission concluded that "on the basis of existing law the accounting treatment to be prescribed should be to flow through the credit to income." Interim Order Issued January 23, 1964, Doc R-232.

These regulatory decisions prompted the drafting of what became section 203(e) of the Revenue Act of 1964. That section carried forward the concept of Chairman Mills HR 7111, but in even broader language. Committee Reports on the new section reviewed the legislative history of section 38, then continued as follows:

> "Despite the statements cited above, the Federal Communications Commission has indicated that it is its policy that any benefits from the investment credit made available by the Revenue Act of 1962 should

> 'flow through' immediately to the customers. In addition, the staff of the Federal Power Commission has recommended the same position. *This is clearly contrary to the intent of Congress in enacting this provision and as a result your committee has added a provision to this bill reasserting its position that it was and is not its intention that the Federal regulatory agencies require the benefit of the investment credit to 'flow through' in this manner.*" H.R. Rep. No. 8363, 88 Cong., 1st Sess. 36-37 (1963). (Emphasis added)

The identical language appears in the Senate Committee Report. See U. S. Code Congressional and Administrative News, 88th Cong. 2nd Sess., No. 3, pp. A-404-405.

Debate in the Senate also leaves no doubt that it was Congress' intent to permit regulated industries to retain the benefit of the credit rather than pass it on to the ratepayer and that it intended to override regulatory law or policies which were incompatible with that objective. The FCC and FPC rulings were placed in the Congressional Record (E.g. 110 Cong. Rec. 1959-1964) and the Senate debate, which was lengthy and sharp, focused specifically on the question of whether these agency decisions should be overturned. Senator Proxmire, a principal opponent of section 203(e), called it:

> "a wholly unprecedented Congressional dictation to regulatory bodies by prohibiting them from deciding the best use to be made of tax credit. . ." 110 Cong. Rec. 2042

In the course of debate on the Proxmire amendment to strike section 203(e), it was understood by all that the issue was one of regulatory agency discretion. Senator Proxmire made this clear:

> "My amendment," he said, "would retain the present law. It leaves the policy decision up to the regulatory body. . ." 110 Cong. Rec. 2075

The Proxmire amendment was supported by many Senators who opposed interference with the regulatory agencies. Senator Williams of Delaware noted:[25]

> "If the section is allowed to remain in the bill, it will specifically provide that the regulatory agencies cannot under any circumstances pass through any of the benefits of the investment credit to the consumers. That is spelled out in clear language."

Senator Magnuson, Chairman of the Commerce Committee, also protested:[26]

> "First, let me say that it seems to me it is not good policy for Congress to set up the Federal Power Commission and expect it to do a good job as between the consumers and the utilities, and give it sufficient authority for that purpose, and then include in a tax bill a provision which would prohibit the Commission from doing certain necessary or desirable things."

Senator Church indicated the sweeping nature of section 203(e):[27]

> "The Senator's amendment is addressed to a single provision in the bill which interferes with the kind of discretion the regulatory Commissions have always had . . ."

And Senator McGovern:[28]

> "I am in agreement that we should not in a tax bill, attempt to legislate the manner in which the utilities should be regulated. . . .
>
> "Even if we were to assume—which I do not think we should assume—that it might be desirable to change the powers of the regulatory commissions, should that be done in a tax bill, or should it be done after careful

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[25] 110 Cong. Rec. 2041.

[26] Ibid at 2041-42 (Emphasis added).

[27] Ibid. at 2050.

[28] Ibid. at 2051.

consideration and review by the Commerce Committee which properly has jurisdiction over this field."

Senator Kuchel:[29]

"It has been recognized by many that section 203(e) is not a tax proposal at all—it is a regulatory proposal, and thus it should not be a tax bill."

Debate on section 203(e) also covered extensively the policy implications of not allowing the credit to be passed through to income and ultimately, it was assumed, to lower rates. Editorials of prominent newspapers describing section 203(e) as a "gift to the utilities" and as a "loophole" were cited (110 Cong. Rec. 2052) and warnings of great cost to the public were issued by opponents of section 203(e).

In response, the proponents of section 203(e) did not deny that the provision was a general amendment of all rate making statutes and a binding limitation on the discretion of the agencies. Senator Carlson, who was a member of the conference committee on the 1962 Revenue Act, review the reasoning underlying the section as follows:

"I, for one, believe we had made it clear that the investment credit was not to be considered a simple reduction in taxes but its purpose was to reduce the cost of providing new productive facilities, thereby increasing the profitability of such facilities and, of course, the incentive to create them.

"In the months following the enactment of the investment credit it became painfully apparent we had not been sufficiently specific. At least one Federal regulatory agency, after reviewing the legislative history of the Revenue Act of 1962, cited the language from the conference report which is quoted above and found that this did not mean that Congress intended the effect of the credit be spread over the life of the plant. This agency specifically found that the invest-

[29] Ibid. at 2054.

ment credit represents a reduction in income taxes that should immediately be flowed through to earnings.

"Section 202(e)[30] simply makes certain that these Federal regulatory bodies will not further misunderstand what the Congress intended and still intends, namely, that the investment credit is to make the construction of plant more profitable over its life and that it is not a mere tax reduction to create an apparent, but not real, increase in net earnings."[31]

Senator Long, another supporter of section 203(e), also understood that a directive to the reglatory agencies was involved:[32]

"So far as Federal commissions are concerned, they are created by Congress and are regarded as an arm of Congress. We establish them and say how they are to do business. We prescribe the general standards that are to be used in determining what a fair return is.

"When we vote a tax cut, a big question is raised. So far as ordinary competitive industry is concerned, industry that is not subject to regulation, it is clear that we intended it to get the benefit of the tax cut which is an investment credit.

"But Congress also voted a similar tax cut for regulated industries. Are we to leave the Commissions in doubt as to whether that credit should be recouped from the carrier or the utility? Should we not have the responsibility of instructing them and saying, "Yes; we intended that they should have this tax cut as an incentive to modernize and expand?

"Mr. Saltonstall. In other words, the Senator from Louisiana is saying that . . . the CAB, with respect to airlines, *should not have any discretion* with relation to the tax investment credit?

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30 Refers to section number of bill. Later enacted as section 203(e).

31 110 Cong. Rec. 2072-73.

32 110 Cong. Rec. 2063.

"Mr. Long of Louisiana. It seems to me that *we should tell them, one way or the other.*" (Emphasis added)

And Senator Morton said:[33]

"I cannot see anything wrong with having Congress tell the regulatory agencies what Congress meant 2 years ago when it passed the 1962 bill."

After this thorough exchange of views, the Proxmire amendment was voted on and defeated. With the ultimate enactment of section 203(e), therefore, the "actual tax" policies of these regulatory agencies were specifically reversed. Under the circumstances, it is difficult to understand how Respondent can still assert its own policy.

B. The Promotional Purposes of Section 406(b) Do Not Justify Its Use by Respondent as a Complete Substitute for the Tax Incentives.

As noted above, the purpose of section 38 was to stimulate the economy by encouraging capital investment in more modern plant and equipment. Respondent states, however, that section 203(e) should not be applied to subsidized airlines because:

"... the encouragement of development and expansion by other regulated industries and by unsubsidized airlines, which section 203(e) of the tax statute was intended to realize, is already provided for subsidized carriers by section 406(b) of the Federal Aviation Act." ... (Order No. E-21663, p. 5.)

This point is developed at greater length at page 35 of Order E-21227 which was incorporated by reference into Order E-21663:

"Actually, *the results intended by section 203(e) for other regulated industries and nonsubsidized airlines—that is, the encouragement of development and expan-*

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[33] Ibid. at 2078.

sion—are already provided for subsidized airlines by section 406(b) of the Federal Aviation Act, which controls the establishment of the class rate. Section 406 (b) requires the Board in fixing subsidy rates to take into consideration:

> '... the need for each such air carrier ... for compensation ... sufficient ... to enable such air carrier ... to maintain and continue the development of air transporation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense.'
>
> "In other words, Congress has provided a comprehensive scheme for fulfilling the need of air carriers for resources to maintain and continue the development of air transportation. If need has been otherwise met under this provision, which was designed to meet the special problems of the airline industry (particularly the subsidized airlines) for certain purposes, it can hardly be argued that the carriers 'need' the benefit of the investment tax credit for the same purposes. The adoption of such a position would merely serve to provide the carriers with subsidy in excess of need,—that is, additional subsidy to cover taxes they do not pay—thereby contravening the provisions of section 406." (Emphasis added)

There are a number of answers to this position.

1. Congress Did Not Authorize Agencies to Ignore Section 203(e) If They Find Existing Statutes Provide Adequate Economic Incentives.

It may be argued that all public utility rates provide an incentive for expansion and modernization if they are to provide a fair return on invested capital. Congress, had it desired to be selective, could have authorized agencies to deny the retention of the tax credit where the existing rate of return was deemed adequate. It did not. Senator Proximire, describing his proposed amendment to strike section 203(e) stated:

> "The reason for the amendment is that I want to leave it in the discretion of the regulatory body. If the amendment fails, the regulatory body will have no discretion." (110 Cong. Rec. 2075)

The amendment did fail. Instead Congress chose to act broadly. It saw a national need and found that the tax credit could best meet that need if granted on a blanket basis, without a selective industry by industry appraisal of whether existing incentives would be adequate.

The possibility that the tax credit would benefit those who did not need the incentive was forcefully noted during debate by Senator Douglas, an opponent of section 203(e), who related this parable:

> "Mr. Douglas: Suppose there were two men, one of whom ate only two meals a day and the other ate four meals a day, and we gave the equivalent of a meal a day in tax credit. The regulatory body says, 'The man who has only two meals a day deserves it so that he can get three meals a day. He gets his three meals a day through the investment credit.'
>
> "Are we then going to say, because we give an extra meal to an underfed man, that we must 'superstuff' a man who is already getting four meals." 110 Cong. Rec. 2057 (1964).

Congress, in enacting section 203(e), responded in the affirmative.

2. Respondent's Approach Creates Competitive Inequities Which Congress Sought to Avoid.

It is important to note that the availability of the tax credit to subsidized airlines would scarcely result in "super stuffing" them. The subsidized carriers, as their need for subsidy attests, do not fall in the category of "overfed" utilities. Their condition contrasts with that of the non-subsidized trunk airlines, which are now enjoying unusually high earnings. Because these latter carriers are not subsidized, Respondent does not have the means to deprive them of the tax credit. Thus it is the very fact of their financial need which makes subsidized carriers vulnerable to Respondent's attack on the tax credit.

The major purpose of Congress in insisting that the tax credit be available to regulated, as well as unregulated, industries was that it did not desire to give one branch of industry a competitive advantage over the other. As Senator Long pointed out:

> "Congress took the attitude at that time that the carriers were entitled to the 7-percent tax credit just as other manufacturing industries were entitled to it. For the reasons that these industries were in competition with one another in seeking to do business with others, . . ." (110 Cong. Rec. 2061)[34]

Congress correctly reasoned that no one segment of the industry should get less of a tax credit than its competitors for buying modern equipment. That reasoning has particular significance for air transportation where ability to attract traffic depends heavily upon ability to offer the most modern competitive equipment obtainable.

The subsidized local service carriers are in competition in many markets with nonsubsidized airlines, and with various forms of surface transportation. Respondent's action is therefore directly and injuriously at odds with Congressional purposes.

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[34] This lesser degree of competition was, as Senator Long pointed out, the reason why an investment credit of 3% was extended to some utilities and 7% to others:

> "So Congress made a distinction in regulated utilities which are regarded on the one hand as being locked-in monopolies, and allowed them one 3-percent investment credit, while it looked at the transportation industry and regarded it as being a competitive industry. Railroads were competing with other railroads. All the railroads were competing with the trucking lines. Both types of carriers were in turn competing with pipelines for customers. Even pipelines were competing with other pipelines. They were all competing with the barge lines, which were in turn competing with tanker fleets." (110 Cong. Rec. 2061).

3. Prior Decisions of This Court Do Not Support Respondent's Action.

This is not the first time this Court has had occasion to deal with the possible incompatability of a tax incentive and utility rate making. In *City of Detroit* v. *Federal Power Commission,* 97 U.S. App. D.C. 260, 230 F. 2d 810 (1956) *cert. denied* 352 U.S. 829 (1956), the petitioner alleged that the Commission had erroneously recognized, for rate purposes, accruals for taxes in excess of those actually paid and, as a result, had not established the "lowest reasonable rates" as required by section 5(a) of the Natural Gas Act, 52 Stat. 821, 15 U.S.C. 717d(a). The purpose of the accruals was to provide reserves for anticipated future taxes which would result from use of the accelerated amortization authority contained in Internal Revenue Code, 26 U.S.C. 124A (1952). (Now 26 U.S.C. 168 (1954)).

The Commission took the position that such accruals were necessary in order to make it possible for the utility to take advantage of the tax incentive. Otherwise the savings would have to be passed along to the consumer and the intent of Congress would be frustrated.

This Court agreed, holding that the tax statute "has a different public policy and should be given the effect intended by Congress." 97 U.S. App. D.C. at 272, 230 F. 2d at 822.

Panhandle Eastern Pipe Line Co. v. *Federal Power Commission,* 115 U.S. App. D.C. 8, 316 F. 2d 659 (1963) *cert. denied* 375 U.S. 881 (1963) involved the Commission's treatment of an analogous provision of the Internal Revenue Code. Section 167, (26 U.S.C. 167 (1954)) provided for liberalized depreciation as an incentive to plant modernization. This Court, in a 5-4 decision, held that the Commission's allowance of a lower rate of return on the reserves accumulated for the "normalized" depreciation was not inconsistent with the objectives of Congress in providing the tax incentive. The *City of Detroit* opinion was

distinguished as pertaining only to the accrual of reserves rather than the return allowable on such reserves. The dissenting opinion argued that the majority in reality overruled *City of Detroit*, and that Congress intended that the entire benefit of the liberalized depreciation, including the full return thereon, should fall to the producer rather than be shared by the consumer.

Regardless of how the *Panhandle* decision squares with the *City of Detroit* opinion, it is not controlling in the instant case. The majority and dissenting opinions in *Panhandle* agreed that:

> "Nothing in the language or legislative history [of section 167] indicates that Congress considered its regulatory consequences." 115 U.S. App. D.C. at 11, 316 F. 2d at 662.[35]

In the present case, Congress obviously *did* consider regulatory consequences—directly and specifically in section 203(e).

4. Section 406(b) Does Not in Fact Offer the Same Incentives as the Tax Statute.

The purposes of section 406(b) and sections 38 and 203(e) are not interchangeably alike. Far from it. The "need" provision of section 406(b) is directed toward the development of "the Commerce of the United States, the Postal Service, and the national defense". Sections 38 and 203(e) are aimed at the stimulation of the economy by the modernization and growth of all private industry. Unlike section 406, no showing of "honest, economical and efficient management" is necessary to obtain the tax

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[35] The dissenting opinion, after referring to the above quotation, states:

"By the same token, nothing in the language or legislative history of Section 167 and 168 indicates that Congress did *not* consider their regulatory consequences." 115 U.S. App. D.C. at 22, 316 F.2d at 673.

credit. In short, the two purposes may produce the same result in any one case; but they need not.

(a) *Respondent has not always found that equipment modernization should be encouraged under section 406(b).*

The history of airline subsidy illustrates that Respondent may find that the purposes of section 406(b) are met *without* the kind of modernization which is sought by the tax credit. For example, in the early 1950's Pioneer Airlines chose to modernize its flight equipment by replacing its DC-3's with Martin 202 equipment. Respondent refused to find that such modernization was required by section 406(b). *Pioneer Airlines Mail Rates*, 17 C.A.B. 499 (1953).[36]

In recent years Respondent has taken a dim view of the modernization of local service aircraft to pure jets. In a *Report to the President* two years ago Respondent stated its view that acquisition of jet aircraft "would involve undue risk of increasing the need of the carrier for subsidy without offsetting benefits in the public interest". Hence, Respondent concluded, acquisition of jet aircraft "should not be underwritten with public funds."[37]

While Respondent's opposition to jets has mitigated recently, its latest revision of the Class Rate still evidences a restrained approach to such modernization.[38]

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[36] "The carrier sought to recover its DC-3's but never got over the financial shock and eventually disappeared by merger with Continental Airlines." Caves, *Air Transport and its Regulators*, Harvard Univ. Press, Cambridge, 1962, p. 261. Respondent's attitude toward Martin 202 and similar aircraft later softened. Today Respondent does not question the use of such equipment.

[37] *Report to the President on Airline Subsidy Reduction Program pursuant to Transportation Message of 1962.* Civil Aeronautics Board, Washington, June 1963. p. 36.

[38] Under Class Rate III pure jet aircraft will be recognized in the computation of gross subsidy "only to the extent that they do not burden the rate more than would the larger type piston powered and turbo-prop equipment now used by the carriers." *Investigation of Local Service Class Subsidy Rate.* Order E-21227, August 31, 1964, p. 14.

(b) *Rates of return actually provided under section 406(b) have provided no more incentive for modernization than rates for nonsubsidized airlines.*

Under section 406(b) Respondent provides no greater incentive for modernization than rates which do not include subsidy. Although section 406(b) includes broad promotional language, Respondent has historically considered its responsibilities thereunder to be discharged by establishing profit margins for subsidized carriers, consistent with those of nonsubsidized carriers, and on the basis of traditional concepts of public utility rate making.

In the *Rate of Return, Local Service Carriers Investigation*, 31 C.A.B. 685 (1960) Respondent adopted an Examiner's conclusion that the "cost of capital" was the appropriate basis for establishing the allowable profit margin. No provision was made for added return because of the promotional objectives of section 406(b).

In the *General Passenger Fare Investigation*, 32 C.A.B. 291 (1960), Respondent also determined that profit margins for nonsubsidized carriers should be based upon the "cost of capital". While a somewhat lower rate of return was found appropriate for the nonsubsidized airlines, this rested solely on the evidence which showed that the cost of capital was in fact somewhat lower for such carriers, which had traditionally offered investors the prospect of higher earnings.

Recently in promulgating Class Rate III, Respondent revised downward the allowable rate of return for local service carriers.[39] That rate is now *below* Respondent's 1960 findings as to a proper rate for non-subsidized

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[39] Respondent found that the new differentiated rate of return should not exceed 11%, as contrasted to the 12.75% permitted previously. Profit sharing however would not begin until a return of 12.50% had been earned. (Order E-21277, p. 50, note 31)

trunklines.[40] A comparison of the rates of return found reasonable by Respondent is as follows:

	% Return on Investment
Nonsubsidized Trunklines[41]	
"Big Four" trunklines	10.5%
"Intermediate Eight" trunklines	11.25%
Subsidized Local Service Airlines	
Rate of Return Investigation (1960)	9%-12.75%
Class Rate III (1964)	9%-11%

Actual return on investment: The rates established by Respondent must be contrasted with what was actually earned. For a long period local service airlines as a group were unable to earn the return to which they were theoretically entitled. This was acknowledged by Respondent in first promulgating the class rate.

> "It is clear that when measured against the standards of a fair return which we have used in the past of 7 percent for past periods and between 8 percent and 12.75 percent for future periods, the results of the individual carriers as well as the carriers as a group have fallen far short of the earnings necessary to maintain financial integrity; . . ." (34 CAB at 431.)

In recent years these earnings have improved, although not all carriers earn the minimum 9% return. This improvement might continue; or it might not. Judging by the past, the Federal Aviation Act provides no guaranty that it will.

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[40] There has been no similar recent review of the rates of return for the trunklines. It is therefore impossible to state whether on the basis of more recent evidence the Board would establish any difference in the fair and reasonable return for subsidized and non subsidized carriers.

[41] From *General Passenger Fare Investigation, supra.*

(c) *Respondent's authority to provide the same incentives with subsidy as the tax statute provides is by no means clear.*

Finally, substantial doubt exists as to Respondent's authority to provide the same incentives under Section 406(b) as offered by the tax credit. *Western Air Lines* v. *C.A.B.*, 347 U.S. 67 (1954) involved an appeal by the Postmaster General of a decision by Respondent permitting the carrier to retain profits from the sale of a route without offset against subsidy need. This was done by Respondent in order "to safeguard the incentive for voluntary route transfers."[42] The Supreme Court held that, however worthy the incentives, Respondent could not allow subsidy in excess of "need".

Delta Airlines v. *Summerfield*, 347 U.S. 74 (1954) involved a decision by Respondent to permit the carrier to retain excess profits of its domestic division without offset against subsidy need for its international services, not because of "need" but "as a matter of economic policy." The Supreme Court held this to be unlawful.

These rulings suggest that an effort by Respondent to provide subsidy to accomplish the same broad national purposes as the tax credit—purposes which go beyond those of section 406(b)—might not be upheld by the Courts.

C. Section 203(e) Is Not Limited to "Commercial Rate" Proceedings.

Another distinction which Respondent relies upon is that, in Section 203(e):

> "Congress intended only to prevent a flow through of the credit to 'consumers' in *commercial rate cases*

[42] Respondent's decision stated:

> "* * * our decision not to include the net profit from the sale of intangibles was reached solely because we are thus seeking to encourage improvement of the air route pattern through voluntary route transfers by other air carriers." (14 C.A.B. 246-47)

> and did not intend to preclude the application of the actual tax policy to investment tax credits in *subsidy cases.*" (Order E-21663, p. 5) (Emphasis added)

Respondent goes on to repeat its distinction between subsidy determinations and what it describes as "a tax statute enacted to govern commercial rate cases". (*Ibid.*)

This distinction is wholly without foundation. Such differences as exist between commercial rates and subsidy rates do not form the basis for an exemption from the sweeping statutory language. Moreover, as we show below, Respondent's view of the law effectively cancels the benefit of the tax credit even for commercial rates where subsidized carriers are involved.

1. Subsidy Rate Making Is Not Significantly Unlike Commercial Rate Making.

The Federal Aviation Act does not provide separately for subsidy rates. Subsidy results only from the establishment of a mail rate under section 406 of the Act. Thus the class rate, under which Petitioner was paid in 1962, was found to be:

> "the fair and reasonable rate of compensation, on and after January 1, 1961, . . . for the transportation of mail by aircraft, the facilities used and useful therefor and the services conneced therewith. . ." *Local Service Class Subsidy Rate*, 34 C.A.B. at 443.[43]

These findings read like that for a typical public utility rate, as does much of the underlying statutory language.[44]

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[43] In 1953 Congress accepted a Presidential recommendation that the subsidy element in mail rates should be identified separately and not paid from Post Office funds. Reorganization Plan 10 of 1953, 67 Stat. 646, 5 U.S.C. 133z, (later enacted as section 406(c) of the Act). However, Congress never accepted the proposition that subsidy be completely separated from mail rates, and it has declined several times to act on legislation proposed by Respondent to accomplish a complete separation. E.g. S. 964, H.R. 7305, 87th Cong., 1st Sess. (1961); S. 1550, H.R. 7597, 86th Cong., 1st Sess. (1959).

[44] Compare, for example, section 406(b)(3) of the Federal Aviation Act with section 1002(c)(5) of the same statute, which provides for the establishment of rates for traffic other than mail.

The Supreme Court has had occasion to note this similarity. In *Transcontinental & Western Air* v. *Civil Aeronautics Board*, 336 U.S. 601, 604 (1949), the Court stated:

> "The language of § 406(a) which empowers the Board to 'fix and determine' after notice and hearing 'the fair and reasonable rates of compensation' for the transportation of mail by aircraft reads like a typical public utility rate-making authority." (footnote omitted)

This Court later observed that with respect to that opinion:

> ". . . the Supreme Court held in the T.W.A. case, supra, that the mail pay provisions of this statute describe a rate-making authority, and the Court said that the statutory language does not suggest that Congress intended to break with the traditions of public utility rate-making." *Summerfield* v. *Civil Aeronautics Board*, 92 U.S. App. D.C. 254, 207 F.2d 200, 205 (1953),[45] *aff'd sub nom* Western Air Lines v. C.A.B., 347 U.S. 67 (1954).

Respondent itself has taken the same view. In *Western Air Lines, Inc.*, 11 C.A.B. 299 (1950) Respondent dealt with a contention that Section 2(c) of the Administrative Procedure Act, 60 Stat. 237, 5 U.S.C. 1001, (which includes the "prescription for the future of rates" within the definition of "rule-making,") did not apply to mail rates. Respondent stated:

> "We cannot agree with this conclusion. While under the Civil Aeronautics Act mail rates are employed as a tool to develop air transportation, *the technique to be used is a public-utility-rate technique.* Both the language and structure of the Act and its legislative history make it clear that the needs of the commerce of the United States, the postal service, and the na-

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[45] See also *Delta Air Lines* v. *Summerfield*, 347 U.S. 74, 78 (1954), where the Supreme Court, referring to the *TWA* Case stated:

> "We also noted in that case that the 'need' clause in Section 406(b) is not wholly at war with traditional rate making functions."

> tional defense were not to be met by direct subsidies, but rather that these needs were additional elements to be considered in fixing 'fair and reasonable rates' for the carriage of mail. The broad statutory considerations and objectives go to the level of the payment rather than to the nature of the technique. *We do not think it is any less a rate merely because the payment is made solely by the Government to the carrier. Capital Airlines* v. *Civil Aeronautics Board,* 171 F.2d 339 (App. D.C. 1948); *T.W.A.* v. *Civil Aeronautics Board,* 336 U.S. 601 (1949)" 11 CAB at 302 (Footnote omitted) (Emphasis added)

The findings which Respondent made in support of its adoption of a Class Rate also rely on the very similarities which it would now deny. In justification of its power to establish a class subsidy rate, Respondent relied first upon the *TWA* case, a decision which emphasized the similarity of subsidy determinations to public utility rate making, and second upon its "Big Four" mail rate decision in 1951. (*American Airlines et al Mail Rates,* 14 C.A.B. 558 (1951)). The latter case involved a rate for mail services only. However, Respondent pointed out in citing the case that, "the rate in fact contained a substantial amount of subsidy" (34 C.A.B. at 416). If a rate for mail service and for subsidy could be so casually intermingled, it is difficult to understand how Respondent can now discern a cleavage between the two so pronounced as to exculpate it from the express wishes of Congress.

2. Subsidy Rates Are Not Distinguishable Because the Government Is the "Consumer".

Respondent relies on the fact that the legislative history of section 203(e) was concerned with whether the benefits of the tax credit should be retained by the utility or be allowed to "flow through" to "consumers". By "consumer" Respondent sees Congress as meaning "customer of the utility". (Order E-21227, p. 34)

It is correct that the impetus for section 203(e) came principally from proceedings before two regulatory

agencies, the FCC and FPC, and that in both cases the question involved was whether the credit should "flow through" to the possible benefit of consumers. Much of the legislative history of the section 203(e) is naturally couched in terms of these particular cases. But from that it cannot be concluded that the legislation applies *only* against a "customer" in the strict sense of that word.

Not one statement in the entire legislative history supports this narrow reading. The debate moreover, indicates a broader purpose. Thus, when Senator Gore was describing the purpose of section 203(e), he stated:

> "That means the regulatory agencies are prohibited from taking into consideration the tax benefits from the investment credit *in arriving at what is a reasonable and fair return on investment* or what are fair and reasonable rates for consumers to pay." (110 Cong. Rec. 2080) (Emphasis added)

Even if Respondent's "customer" limitation were true, it is questionable whether its argument would be aided. As noted above, subsidy rates are still rates paid for mail services for which the government is the customer. Even considered separately, the subsidy element is paid only for services rendered. The class rate provides that subsidy is paid only to the extent certificated services are provided, at the rate of so much for each seat mile. *Class Rate Order*, Par. IA, 34 C.A.B. at 420. The government is buying public air transportation with subsidy in a manner not entirely foreign to how it buys its own air transportation service when it makes an air shipment on a government bill of lading.

The distinction Respondent would make is, if sound, one of far-reaching consequence. If air carrier subsidy has been excluded from the statute, *sub silentio*, other federal subsidy programs have also been excluded, and a widespread effort is required by other agencies of the Federal

Government to re-examine these programs[46] to insure that the subsidy does not duplicate the tax credit.[47]

3. Respondent's View Would Deny the Benefit of the Tax Credit Even in Commercial Rate Making Where Subsidized Carriers Are Involved.

Respondent appears to acknowledge its duty to permit carriers to retain the benefit of the tax credit in fixing "commercial" rates. While Respondent rarely exercises its power to establish such rates, it is important to consider the effect if it were called upon to do so for a subsidized carrier. The commercial rate would presumably provide for a return of a stated per cent; but the carrier would be entitled to that per cent plus the benefit of any tax credit.

However, Respondent's subsidy policy would completely negate this action. In fixing subsidy the tax credit would be considered, and subsidy reduced accordingly. Hence, what was allowed in the commercial rate would be taken away by a reduced subsidy rate.

It is hard to imagine that Congress intended to give Respondent the authority to take away with one rate what it is required to allow with another. This is precisely the sort of thing section 203(e) is aimed at when it enjoins agencies from "accomplishing a similar result by any other method."

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[46] A prime example is the construction differential subsidy program under which the Maritime Administration makes up the difference between construction costs in foreign and domestic shipyards. Ships also qualify for the investment tax credit. Under Respondent's view, the Maritime Administration might be obligated to deduct the tax credit from the construction subsidy.

[47] A recent Congressional publication listed numerous Federal "subsidy" programs of various kinds. *Subsidy and Subsidy-Effect Programs of the U.S. Government*, 89th Cong., 1st Sess. (1965) (Joint Economic Committee).

D. Section 203(e) Does Not Constitute a Retroactive Change in the Rate. The Rate Automatically Gives Effect to Changes in the Tax Laws. Section 203(e) is Such a Change and Should Have Been Given Effect.

Respondent's contention on this point is as follows:

> "... While the tax statute was apparently intended to govern commercial rate cases *in esse* covering periods prior to enactment of the legislation, we cannot conceive that when Congress in 1964 prohibited agencies, in the absence of taxpayer consent, from passing investment tax credit benefits through to consumers, it intended to change even commercial rates already fixed for earlier years, much less to make a retroactive change in a class subsidy rate established prospectively covering the year 1962." (Order E-21663, p. 5)

Respondent is wrong. There is no retroactive effect because the rate is designed to accommodate changes in the Internal Revenue Code.

Respondent wisely did not peg the determination of income taxes to the tax laws in effect at the time the rate was promulgated in 1961. In describing taxes to be considered in a profit showing determination the class rate speaks of taxes actually applicable for the period in question. This open-ended feature was appropriate for rate designed to last indefinitely.

We submit however that Respondent is obliged to take account of *all* changes in the tax laws. Both Section 38 and section 203(e) were enacted after the rate was closed.[48] Respondent cannot say that its taking of the section 38 tax

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[48] The fact that section 203(e) was enacted in 1964 and section 38 in 1962 does not make the former any more retroactive. The 1964 amendment is a clarification of the 1962 Act ("*It was the intent* of Congress in providing an investment tax credit . . ." section 203(e)). This was a clarification which many thought should have been unnecessary in view of the legislative history of the 1962 Act. (See remarks of Senator Long in debate on section 203(e), 110 Cong. Rec. 2061-62; Senator Anderson, 110 Cong. Rec. 2063; Senator Carlson, 110 Cong. Rec., 2072-73.)

credit is *not* a retroactive change in the rate, but that adherence to section 203(e) *is* a retroactive change.[49]

This is a direct and arbitrary flouting of Congressional will. An essential feature of the tax credit is the accompanying restraint on the regulatory agencies. Section 38 establishes the credit. Section 203(e) makes clear that, insofar as fixing the cost of service of regulated companies is concerned, the credit must be regarded as non-existent. This condition is part and parcel of the credit.

II. PETITIONER IS NOT PRECLUDED BY ITS ACCEPTANCE OF THE RATE FROM CHALLENGING THE VALIDITY OF RESPONDENT'S ORDER.

Respondent suggests that one of the issues here is as follows:

> "... whether petitioner is precluded from challenging the Board's determination by its failure to object before the Board to the terms of Order E-16485, *supra*, its failure to seek review of that order, and/or its acceptance of benefits thereunder?"

Respondent's position is apparently that Petitioner is bound because it "did not raise objection to the class rate when it was established". (Order E-21663, p. 5).

A. In Accepting the Class Rate, Petitioner Did Not Consent to the Taking of the Tax Credit.

Petitioner's acceptance of the class rate does not bar it from the benefit of the tax credit. The class rate order does not cover the treatment of investment tax credits in profit sharing determinations. This is readily understandable; there was no investment tax credit in 1961. Petitioner can-

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[49] We do not understand Respondent to take the position that Congress may not retroactively increase subsidy rates. See: *United States* v. *Lindsay*, 346 U.S. 568, 570 (1954) ("Congress has unquestioned right to bar recovery on government claims if it sees fit").

not be held to have waived its right to a credit which neither it nor Respondent considered.

Respondent would have it otherwise. In its view the "actual tax policy" is implicit in the Class Rate Order, and under that policy it is entitled to take the credit as an offset to subsidy. We disagree.

Under the rate order, the return to which a carrier is entitled before profit sharing is established at certain amounts "after applicable income taxes", a phrase which appears five times in Part II of that order.[50] The word "applicable" clearly qualifies the term income taxes. It would appear that section 203(e) clearly makes the tax credit inapplicable to a determination of taxes.

Part III of the order sets forth the provisions in accordance with which the computation of the various profit sharing elements, including income taxes, is to be made.

Under the item "Income Taxes" the following appears:

> "F. Income taxes.—Federal and State income taxes shall be determined on the basis of the carrier's income tax returns for each year as submitted to the taxing authorities, which such amendments or revisions (including tax carry-back and carry-forward credits) as may have been filed as of the date of the final determination of excess profits (or an earnings deficiency) under this order; *Provided, however,* That for carriers whose tax returns are filed for a 12-month period not coinciding with a calendar year, a pro forma tax return will be required to be submitted for the calendar year, which return shall be prepared on bases consistent with the returns of that carrier filed for the latest fiscal year with the appropriate tax authorities. (Footnote omitted)

Although the provision relates the determination of taxes to a carrier's tax return, it in no manner calls for the consideration of taxes which are not "applicable". Nor is it

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[50] See Part II A, Appendix C.

even clear that a tax credit is a change in "income taxes" within the meaning of the Class Rate Order.[51]

It is also significant that the rate order specifically mentions carry-back and carry-forward credits. If the order automatically embraced all credits, this was unnecessary. Under the principle of *expressio unius est exclusio alterius,* no other credits are included.

Such a conclusion is supported by Respondent's most recent modification of the rate, Class Rate III. That order, which was issued *after* enactment of the investment tax credit, does not assume that the credit is covered by the general language. Instead, specific reference is made to it.[52] Despite the fact that Class Rate III mentions the investment tax credit and Class Rate I does not, Respondent now maintains both orders mean the same thing.

B. Petitioner Has Not Since Consented to the Taking of the Credit by Respondent.

The record makes it perfectly clear that no statement or course of conduct by Petitioner after the enactment of section 38 can be taken as "consent" within the meaning of section 203(e). In submitting its original calculation of proposed profit sharing, Petitioner assumed the credit to be retained by it. (J.A. 99). When Respondent replied with

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51 The U.S. Corporation Income Tax Return for 1962 (Form 1120) lists "Total income tax" on line 31 (JA 155). Credits, including prior payments and investment credits, are deducted to determine the amount due. Strictly speaking, therefore, the tax credit is a reduction in the amount payable, but not the tax itself.

52 Paragraph III E of Class Rate III (Order E-21227, p. 64, Aug. 28, 1964), states in part as follows:

"E. *Income Taxes*

1. Federal income taxes shall be determined on the basis of the carrier's actual income taxes, including the reduction of taxes resulting from loss carrybacks and carryovers *and from investment tax credits,* as reported on its income tax returns submitted to taxing authorities for each year, with such amendments and revisions as may have been filed as of the final determination of profit-sharing hereunder; . . ." (Emphasis added)

a contrary calculation (J.A. 177), Petitioner voiced its objection (J.A. 233) and subsequently submitted a 25-page letter and memorandum in support of its position (J.A. 238).[53] Petitioner also voiced its objection at the time Respondent deducted from current subsidy payments the amounts allegedly owed by Petitioner for 1962 profit sharing (J.A. 285).

III. JURISDICTION OF THIS MATTER LIES IN THIS COURT.

One of the issues raised by Respondent is:

> "Whether jurisdiction to review the actions of the Board here complained of lies in this Court under section 1006 of the Federal Aviation Act, 49 U.S.C. 1486, or section 10 of the Administrative Procedure Act, 5 U.S.C. 1009; or whether such jurisdiction lies only in the Court of Claims under the doctrine of *Mohawk Airlines* v. *Civil Aeronautics Board*, 329 F. 2d 894 (1964)."

This Court clearly has jurisdiction under section 1006(a) of the Federal Aviation Act, 72 Stat. 795, 49 U.S.C. 1486 (Appendix A), which provides in part for review by the Court of Appeals of "any order, affirmative or negative, issued . . . under this Act . . ."

First, it is a final order.[54] It imposed an obligation upon Petitioner to "refund $556,103 to the Government", which amount included the $25,660 investment tax credit. Compliance with this order could be compelled by civil and even criminal penalties, pursuant to sections 901 and 902 of the Federal Aviation Act, 72 Stat. 783, 784, 49 U.S.C. 1471, 1472.

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[53] As noted in the "Statement of the Case", *supra* p. 2, profit sharing determinations are handled informally and no hearing procedure is contemplated by Respondent. Efforts of Petitioner to obtain a hearing in connection with 1961 profit sharing were rebuffed.

[54] For an order to be reviewable under section 1006(a) it must "impose an obligation, deny a right or fix some legal relationship". *Chicago and Southern Airlines* v. *Waterman S.S. Corp.*, 333 U.S. 103, 112-113 (1948).

Second, the order is also issued "under" the Federal Aviation Act. It pertains to, and is in furtherance of, subsidy rates established pursuant to section 406 of that Act.

Mohawk Airlines v. *CAB*, 117 U.S. App. D.C. 326, 329 F. 2d 894 (1964) is not controlling in this instance for several reasons:

A. The Mohawk Case Involved a Letter, Not an Order.

The appeal was taken from a letter to Mohawk advising it that Respondent intended to deduct $18,204 from its next subsidy payment. As the Court noted, the letter "did not purport to be an order". (117 U.S. App. D.C. at 328, 329 F. 2d at 896) It was a letter, pure and simple. It required Mohawk to do nothing. No compliance was required and no possible penalties attached.

The Mohawk letter stated:

> ". . . [The] Board has determined to disallow those claimed extra section miles on which no passengers were carried in the computation of Mohawk's subsidy . . . . Accordingly, we intend to make an off-set of $18,204.16 against your next regular monthly subsidy payment." 117 U.S. App. D.C. at 328, 329 F. 2d at 896.

By contrast the North Central Order stated:

> "Accordingly, IT IS ORDERED, That North Central Airlines, Inc., shall refund $556,103 to the Government pursuant to the provisions of Class Rate I, for the calendar year 1962." Order E-21663, p. 6.

B. Respondent's Order E-21663 Is Not "a Statement of Intention to Act Under Section 322 of the Transportation Act".

In the *Mohawk Case*, this Court observed that Respondent's letter was "a statement of intention to act under Section 322 of the Transportation Act", 117 U.S. App. D.C. at 329, 329 F. 2d at 897. Order E-21663 does not pertain to the recapture of an overpayment under the Transportation Act of 1940. The section 322 to which reference

was made in the *Mohawk Case* was that in effect prior to a 1958 amendment.[35] It provided as follows:

> "'Payment for transportation of the United States mail . . . by any common carrier subject to . . . the Civil Aeronautics Act of 1938, shall be made upon presentation of bills therefor, prior to audit or settlement by the General Accounting Office, *but the right is reserved to the United States Government to deduct the amount of any overpayment to any such carrier from any amount subsequently found to be due such carrier.*' 54 Stat. 955, 49 U.S.C. 66 (1940). (Emphasis added.)

The amended section 322 applies to this case. The revised Act substantially narrows section 322 of the Transportation Act of 1940. Where the right to deduct under the original Act applied to "any overpayment for the transportation of mail", the 1958 amendment limited that right to "any overcharges by any such carrier". A definition of "overcharges" was added:

> "The term 'overcharges' shall be deemed to mean charges for transportation services in excess of those applicable thereto under the tariffs lawfully on file with the Interstate Commerce Commission and the Civil Aeronautics Board and charges in excess of those applicable thereto under rates, fares, and charges established pursuant to section 22 of this title." (49 U.S.C. 66)

Thus, section 322 is no longer available to recover "any overpayment" (which could include subsidy) but only "any overcharge" in excess of "tariffs lawfully on file". Subsidy is not paid pursuant to tariffs. Respondent's order, therefore, cannot be an order pursuant to the Transportation Act. Its only statutory basis is the Federal Aviation Act, in which event this Court has jurisdiction and must proceed to the merits.

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[35] The amendment applied, by its own terms, only to transactions after 1958. The transaction involved in the *Mohawk Case* took place prior thereto. 72 Stat. 860, 47 U.S.C. 66 (1958).

CONCLUSION

For the foregoing reasons, Petitioner asks this Court to reverse and set aside Respondent's Order insofar as it pertains to the investment tax credit, and remand the case to Respondent for further proceedings consistent with the Court's determination.

Respectfully submitted,

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Dated: July 6, 1965

APPENDIX A

Applicable Statutes

1. Section 38 of the Internal Revenue Code of 1954 reads as follows:

"§ 38. Investment in certain depreciable property

(a) General Rule.—There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations.—The Secretary of his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B. Added Pub. L. 87-834, § 2(a), Oct. 16, 1962, 76 Stat. 962."

2. The pertinent provisions of Section 46 of the Internal Revenue Code (Sections 46(a)(1) through (3) and 46(c)(1) through (3)) are as follows:

"§ 46. Amount of credit

(a) Determination of amount.—

(1) General rule.—The amount of the credit allowed by section 38 for the taxable year shall be equal to 7 percent of the qualified investment (as defined in subsection (c)).

(2) Limitation based on amount of tax.—Notwithstanding paragraph (1), the credit allowed by section 38 for the taxable year shall not exceed—

(A) so much of the liability for tax for the taxable year as does not exceed $25,000, plus

(B) 25 percent of so much of the liability for tax for taxable year as exceeds $25,000.

(3) Liability for tax.—For purposes of paragraph (2), the liability for tax for the taxable year shall

be the tax imposed by this chapter for such year, reduced by the sum of the credits allowable under—

(A) section 33 (relating to foreign tax credit),

(B) section 35 (relating to partially tax-exempt interest), and

(C) section 37 (relating to retirement income).

for purposes of this paragraph, any tax imposed for the taxable year by section 531 (relating to accumulated earnings tax) or by section 541 (relating to personal holding company tax) shall not be considered tax imposed by this chapter for such year.

"(c) Qualified investment.—

(1) In general—For purposes of this subpart, the term 'qualified investment' means, with respect to any taxable year, the aggregate of—

(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b) placed in service by the taxpayer during such taxable year, plus

(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48(c)(1) placed in service by the taxpayer during such taxable year.

(1) placed in service by the taxpayer during such taxable year.

(2) Applicable percentage.—For purposes of paragraph (1), the applicable percentage for any property shall be determined under the following table:

If the useful life is—	The applicable percentage is—
4 years or more but less than 6 years	33⅓
6 years or more but less than 8 years	66⅔
8 years or more	100

For purposes of this paragraph, the useful life of any property shall be determined as of the time such property is placed in service by the taxpayer.

(3) Public utility property.—

(A) In the case of section 38 property which is public utility property, the amount of the qualified investment shall be 3/7 of the amount determined under paragraph (1).

(B) For purposes of subparagraph (A), the term 'public utility property' means property used predominantly in the trade or business of the furnishing or sale of—

(i) electrical energy, water, or sewage disposal services,

(ii) gas through a local distribution system,

(iii) telephone services, or

(iv) telegraph service means of domestic telegraph operations (as defined in section 222(a) (5) of the Communications Act of 1934, as amended; 47 U.S.C. sec. 222 (a) (5)),

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public utility commission or other similar body of any State or political subdivision thereof."

3. Section 203(e) of the Revenue Act of 1964 (78 Stat. 19) reads as follows:

"TREATMENT OF INVESTMENT CREDIT BY FEDERAL REGULATORY AGENCIES.—It was the intent of the Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in

basis required by section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use—

(1) in the case of public utility property (as defined in section 46(c)(3)(B) of the Internal Revenue Code of 1954), more than a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed) of the credit against tax allowed for any taxable year by section 38 of such Code, or

(2) in the case of any other property, any credit against tax allowed by section 38 of such Code,

to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the tax-

payer or to accomplish a similar result by any other method."

The pertinent provisions of the Federal Aviation Act of 1958, 72 Stat. 737 *et seq.*, 49 U.S.C. §§ 1301 *et seq.*. are as follows:

RATES FOR TRANSPORTATION OF MAIL
Authority to Fix Rates

SEC. 406. [*72 Stat. 763, as amended by 76 Stat. 145, 49 U.S.C. 1376*] (a) The Board is empowered and directed, upon its own initiative or upon petition of the Postmaster General or an air carrier, (1) to fix and determine from time to time, after notice and hearing, the fair and reasonable rates of compensation for the transportation of mail by aircraft, the facilities used and useful therefor, and the services connected therewith (including the transportation of mail by an air carrier by other means than aircraft whenever such

transportation is incidental to the transportation of mail by aircraft or is made necessary by conditions of emergency arising from aircraft operation), by each holder of a certificate authorizing the transportation of mail by aircraft, and to make such rates effective from such date as it shall determine to be proper; (2) to prescribe the method or methods, by aircraft-mile, pound-mile, weight, space, or any combination thereof, or otherwise, for ascertaining such rates of compensation for each air carrier or class of air carriers; and (3) to publish the same.

Rate Making Elements

(b) In fixing and determining fair and reasonable rates of compensation under this section, the Board, considering the conditions peculiar to transportation by aircraft and to the particular air carrier or class of air carriers, may fix different rates for different air carriers or classes of air carriers, and different classes of service. In determining the rate in each case, the Board shall take into consideration, among other factors, (1) the condition that such air carriers may hold and operate under certificates authorizing the carriage of mail only by providing necessary and adequate facilities and service for the transportation of mail; (2) such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law; and (3) the need of each such air carrier (other than a supplemental air carrier) for compensation for the transportation of mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense.

Payment

(c) The Postmaster General shall make payments out of appropriations for the transportation of mail by aircraft of so much of the total compensation as is fixed and determined by the Board under this section without regard to clause (3) of subsection (b) of this section. The Board shall make payments of the remainder of the total compensation payable under this section out of appropriations made to the Board for that purpose.[1]

JUDICIAL REVIEW OF ORDERS

Orders of Board and Administrator subject to Review

SEC. 1006. [*72 Stat. 795, as amended by 74 Stat. 255, 75 Stat. 497, 49 U.S.C. 1486*] (a) Any order, affirmative or negative, issued by the Board or Administrator under this Act, except any order in respect of any foreign air carrier subject to the approval of the President as provided in section 801 of this Act, shall be subject to review by the courts of appeals of the United States or the United States Court of Appeals for the District of Columbia upon petition, filed within sixty days after the entry of such order, by any person disclosing a substantial interest in such order. After the expiration of said sixty days a petition may be filed only by leave of court upon a showing of reasonable grounds for failure to file the petition theretofore.

Venue

(b) A petition under this section shall be filed in the court for the circuit wherein the petitioner resides or has his principal place of business or in the United States Court of Appeals for the District of Columbia.

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[1] Subsections (d) through (h) of Section 406 have been omitted as not pertinent to the issues in this appeal.

Notice to Board or Administrator; Filing of Transcript

(c) A copy of the petition shall, upon filing, be forthwith transmitted to the Board or Administrator by the clerk of the court, and the Board or Administrator shall thereupon file in the court the record, if any, upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code.

Power of Court

(d) Upon transmittal of the petition to the Board or Administrator, the court shall have exclusive jurisdiction to affirm, modify, or set aside the order complained of, in whole or in part, and if need be, to order further proceedings by the Board or Administrator. Upon good cause shown and after reasonable notice to the Board or Administrator, interlocutory relief may be granted by stay of the order or by such mandatory or other relief as may be appropriate.

Findings of Fact Conclusive

(e) The finding of facts by the Board or Administrator, if supported by substantial evidence, shall be conclusive. No objection to an order of the Board or Administrator shall be considered by the court unless such objection shall have been urged before the Board or Administrator or, if it was not so urged, unless there were reasonable grounds for failure to do so.

Certification or Certiorari

(f) The judgment and decree of the court affirming, modifying, or setting aside any such order of the Board or Administrator shall be subject only to review by the Supreme Court of the United States upon certification or certiorari as provided in section 1254 of title 28, United States Code.

The pertinent provisions of the Administrative Procedure Act, 60 Stat. 273 *et seq.*, 5 U.S.C. 1001 *et seq.* are as follows:

JUDICIAL REVIEW

SEC. 10. [*60 Stat. 243; 5 U.S.C. 1009*] Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—

(a) RIGHT OF REVIEW.—Any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute, shall be entitled to judicial review thereof.

(b) FORM AND VENUE ACTION.—The form of proceeding for judicial review shall be any special statutory review proceeding relevant to the subject matter in any court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action (including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus) in any court of competent jurisdiction. Agency action shall be subject to judicial review in civil or criminal proceedings for judicial enforcement except to the extent that prior, adequate, and exclusive opportunity for such review is provided by law.

(c) REVIEWABLE ACTS.—Every agency action made reviewable by statute and every final agency action for which there is no other adequate remedy in any court shall be subject to judicial review. Any preliminary, procedural, or intermediate agency action or ruling not directly reviewable shall be subject to review upon the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final shall be final for the purposes of this subsection whether or not there has been presented or determined any application for a declaratory order, for any form of reconsideration, or (unless the agency otherwise requires by rule and provides that the action

meanwhile shall be inoperative) for an appeal to superior agency authority.

(d) INTERIM RELIEF.—Pending judicial review any agency is authorized, where it finds that justice so requires, to postpone the effective date of any action taken by it. Upon such conditions as may be required and to the extent necessary to prevent irreparable injury, every reviewing court (including every court to which a case may be taken on appeal from or upon application for certiorari or other writ to a reviewing court) is authorized to issue all necessary and appropriate process to postpone the effective date of any agency action or to preserve status or rights pending conclusion of the review proceedings.

(e) SCOPE OF REVIEW.—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.

APPENDIX B

C.A.B. Order E-21663

UNITED STATES OF AMERICA CIVIL AERONAUTICS BOARD
WASHINGTON, D. C.

Adopted by the Civil Aeronautics Board
at its office in Washington, D. C.
on the the 11th day of January, 1965

Docket 12004

LOCAL SERVICE CLASS SUBSIDY RATE
(NORTH CENTRAL AIRLINES, INC., SUBSIDY REFUND—1962)

ORDER DETERMINING SUBSIDY REFUND

In this Order the Board has determined, pursuant to the provisions of Class Rate I,[1] that North Central Airlines, Inc. shall refund $556,103 of subsidy for the calendar year 1962. In adopting Class Rate I, the Board established a class rate system for payment of subsdiy to the local service carriers. Class Rate I, which was final and in effect for all thirteen local carriers—with one exception not relevant here—for calendar years 1961 and 1962, contains specific provisions, which, under certain conditions, provide for refund to the Government of a portion of the subsidy paid to the various local carriers. The amount of such refund, if any, is ascertained in each case on the basis of a profit-sharing scale set forth in the section of the class rate containing the rate formula. The detailed provisions for computing the income, expense, investment and tax elements entering into the profit-sharing or subsidy refund calculation—which calculation is required to be made for calendar

[1] Local Service Class Subsidy Rate Investigation, 34 C.A.B. 416, 418 (1961).

years 1961 and 1962—are contained in sections II and III of the rate formula.[2]

To facilitate the profit-sharing and subsidy refund provided for in Class Rate I, the Board requires each local service carrier to submit a special report, Form T-88, on an annual basis.[3] This form and the provisions of the class rate which it effectuates are so designed that the administration of profit-sharing and subsidy refund does not involve rate-making determinations, but solely the ascertainment of the pertinent facts and the application of the provisions of the formula to those facts.[4]

On April 12, 1963, North Central submitted the required CAB Form T-88 in connection with the determination of the amount of profit-sharing for 1962.

In accordance with established practice, North Central's Form T-88 for calendar 1962, as amended, has been subjected to field audit by the Board's staff at the site of the carrier's operations and a staff report of the audit findings has been made to the Board. Upon review of the audit report, the carrier's Form 41 reports, the data contained in the carrier's T-88 report, and the supplemental materials developed in communications and discussions between North Central and the Board's staff, the Board has con-

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[2] The original class subsidy rate was replaced in revised form by Class Rate II, as of January 1, 1963 (Order E-19340, March 1, 1963, and Order E-19405, March 22, 1963) and by Class Rate III, as of July 1, 1964 (Order E-21227, August 28, 1964, and Order E-21311, September 22, 1964). The profit-sharing or subsidy refund provisions of the revised rates are substantially similar to those of the original rate formula. In addition, under the applicable formula an earnings deficiency for 1962 may be carried forward for two successive years as an offset against profits in such two years.

[3] Form T-88 is entitled "Report of Earnings Subject to Profit-Sharing Pursuant to the Provisions of Local Service Class Subsidy Rate, Docket 12004, Order E-16485, As Amended."

[4] Since Class Rate I is final, as is true of all class rates, its provisions are not open to contest retroactively and are not in issue in determinations such as the instant one.

cluded that under the terms of Class Rate I North Central shall refund $556,103 in subsidy for calendar year 1962. The Form T-88 submitted by the carrier for 1962 conforms to, and is consistent with, the requirements of Class Rate I, except in the following respects:

1. Section III A 1 of the Class Rate requires that reports of revenues be consistent with the reporting requirements of the Act and the Board's Regulations. Pursuant to this section and in connection with the 1961 subsidy refund determination involving North Central (Order E-21319, September 23, 1964), a number of adjustments to the carrier's 1962 T-88 are required:

(a) In 1961 the carrier determined that $49,428 of interline traffic payables were aged and not likely to become the basis of claims. In our profit-sharing order we therefore included this item in the carrier's 1961 revenues. However, the carrier did not transfer the amount to passenger revenue until 1962, and, as a result, the item has been included in its T-88 report for that year. Consistent with our prior adjustment, the $49,428 has been eliminated from the reported 1962 revenues.

(b) An escrow deposit was excluded from the carrier's investment as a restricted fund. That deposit earned $2,701 in interest in 1961 but this amount was not recorded until 1962. Consistent with our prior elimination of the investment, the interest income has been excluded from 1962 revenues.

(c) In 1961 the carrier's T-88 was adjusted to reflect a workmen's compensation insurance premium credit but the carrier did not make the appropriate book entry until 1962. In view of our prior adjustment, $3,655 has been eliminated from the income reported on the carrier's 1962 T-88 report.

2. Under section III B 1 of the Class Rate, expenses reported for profit-sharing must be consistent with the reporting requirements of the Act and the Board's account-

ing regulations. Pursuant to this section, the following adjustments have been made:

(a) In connection with the 1961 profit-sharing determination developmental costs in the amount of $3,768 and expenditures in the amount of $8,636 were eliminated from operating expenses since they should have been capitalized. In 1962 the carrier effected the necessary corrective action on its books and this is reflected in the T-88 reports. Therefore, in view of the 1961 adjustment, an appropriate modification has been made to the carrier's 1962 reported results.

(b) As of January 1, 1962, North Central began the amortization of a prepayment relating to the lease of a water reservoir and pump house facilities at O'Hare International Airport in Chicago. The period of amortization was fixed by the carrier at five years, but prepaid rent on hangar facilities at the airport is being amortized over 20 years. Since the reservoir and pump house are part of the overall airport facilities and have the same expected useful service life to the carrier, recovery of these costs should also be amortized over a 20-year period. Therefore, the reported results have been adjusted to eliminate $24,127, representing the amount of excess amortization taken by the carrier.

(c) We have excluded from operating expenses $1,609 for legal fees and expenses relating to the acquisition of aircraft. Under the Board's accounting regulations these expenses should have been capitalized in the appropriate property accounts, and the carrier's T-88 has been adjusted accordingly.

3. In North Central's last individual subsidy case[5] various disallowances were made with regard to DC-3 maintenance and obsolescence expense. In its 1962 expenses the carrier reported $51,652 of these disallowed costs. In

[5] 34 C.A.B. 126 (1961).

view of their prior nonrecognition, these expenses have been excluded for profit-sharing purposes.

4. Paragraph j of section III B 3 requires the disallowance of expenses incurred for proceedings in which the carrier is an unsuccessful applicant for a route award. In addition, this provision also provides that expenses incurred during the prosecution of an exemption or route award be held in abeyance pending final decision of the Board. Under this provision, $16,244 of miscellaneous developmental costs charged to operating expenses have been excluded.

5. Financing costs and costs related to financing are nonallowable expenses as specified in paragraph c of section III B 3. In this category we have eliminated $10,339 from operating expenses. Of this amount $7,985 represents half of the salary and expenses of an assistant to the chairman of the carrier's board of directors. On the basis of the audit report and information submitted by the carrier we have concluded that 50 percent of the assistant's time was devoted to matters directly related to financing, and therefore that portion of his salary and expenses has not been recognized.[6]

6. Paragraphs h and 1 of section III B 3 provide, respectively, for the disallowance of dues expensed on behalf of the carrier or any officer or director, unless such dues are for membership in business, professional, or trade organizations and for the disallowance of charitable contributions.

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[6] A similar disallowance was made in North Central's 1961 profit-sharing determination. The carrier's argument that such of the assistant's time as was devoted to financing was concerned with debt financing and that the return element on debt does not include an allowance for such financing costs must be rejected. All appropriate costs of floating debt are includable in the return on debt investment, and the return on debt element embodied in the Class Rate adequately covers such costs. Further, any challenge to the return on debt element should have been made at the time the Class Rate was established, rather than indirectly in a profit-sharing proceeding. Our prior discussion of this matter is equally applicable in the current proceeding and is incorporated by reference herein. Order E-21319, pp. 4-5, September 23, 1964.

Pursuant to these sections we have excluded $500 and $550, respectively.

7. A review of North Central's reported results reveals that $7,839 of expenses of a vice-president who maintained an out-of-town office should not be recognized. A similar disallowance was made in connection with the 1961 profit-sharing determination. Contrary to the carrier's apparent position our disallowances for 1962, as well as for 1961, are not primarily based on a lack of support of the fact of the expenditures having been made, but on our findings that the expenses did not reasonably relate to the air transport services of North Central. Accordingly, pursuant to paragraph n of section III B 3, we have excluded these expenses from the carrier's T-88.

8. Pursuant to section III E of the Class Rate Order, the carrier's T-88 investment has been adjusted, where appropriate, to reflect the various adjustments detailed above. In addition, the following adjustments to the carrier's investment have been made:

(a) A downward adjustment has been made to reflect the actual profit-sharing liability for 1961, as determined for class rate purposes.

(b) In a prior subsidy case, certain extension and development costs were disallowed. In adjusting its T-88 investment for this disallowance, the carrier removed the unamortized portion of this item ($96,000) from both debt and equity on a prorate basis. However, since the disallowed item was directly traceable to equity, it should have been removed from equity only, and we have adjusted the T-88 accordingly.

9. In accordance with section III F, which provides for recognition of actual taxes only, we have adjusted the carrier's computation of income taxes to take into account an investment tax credit of $25,660. North Central took the benefit of this credit in its tax return for 1962, but did

not apply the credit for purposes of its T-88 tax computation, claiming that section 203(e) of the Revenue Act of 1964 requires the Board to ignore this tax saving for profit-sharing purposes. Acceptance of the carrier's T-88 would have the result of increasing the actual tax allowance to the extent of the tax credits.

The Board recently had occasion to review in detail the question whether the Revenue Act of 1964 required us to exclude investment tax credits from actual tax treatment for purposes of profit-sharing determinations for calendar year 1964 and subsequent years under Class Rate III.[7] Our review of the Revenue Act and its legislative history convinced us that the Congress intended only to prevent a flow-through of the credit to "consumers" in commercial rate cases and did not intend to preclude the application of the actual tax policy to investment tax credits in subsidy cases. Since the encouragement of development and expansion by other regulated industries and by unsubsidized airlines, which section 203(e) of the tax statute was intended to realize, is already provided for subsidized carriers by section 406(b) of the Federal Aviation Act, providing subsidy to cover taxes which the carriers do not pay would contravene the prohibition against providing subsidy in excess of the statutory "need". We would not read section 203(e) as incompatible with section 406 without a clear statement that the Congress desired such a result, and we have found nothing to indicate that Congress ever considered the consequences of section 203(e) in subsidy rate-making proceedings.

Moreover, the applicability to administrative determinations of excess profits and excess subsidy of a tax statute enacted to govern commercial rate cases appears even more

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[7] (Statement of Provisional Findings and Conclusions) Order E-21227, August 28, 1964, (Final Order) Order E-21311, September 22, 1964. Our discussion of the investment tax credit, set forth on pages 32-36 of Order E-21227, is hereby incorporated by reference herein.

remote. North Central did not raise objection to the Class Rate when it was established. While the tax statute was apparently intended to govern commercial rate cases *in esse* covering periods prior to enactment of the legislation, we cannot conceive that when Congress in 1964 prohibited agencies, in the absence of taxpayer consent, from passing investment tax credit benefits through to consumers, it intended to change even commercial rates already fixed for earlier years, much less to make a retroactive change in a class subsidy rate established prospectively covering the year 1962. The Board's actual tax principle will continue[8] to govern our administrative determinations pursuant to class rates as well as other subsidy cases.[9] We will apply the credit to the tax allowance for North Central and make appropriate adjustments to investment.

10. The carrier's Form T-88 showed that the subsidy payable under the formula, prior to reduction for profit-sharing, was greater than the amount it had reported on its Form 41. However, the related income tax liability was not adjusted upward to reflect the greater amount of subsidy payable under the formula. Accordingly, an appropriate adjustment has been made to income taxes. Correspondingly, the reported investment shown by North Central on its T-88 has been adjusted upward to reflect the net greater amount of subsidy after taking into account the related income tax liability.

With the revisions indicated above, and after reflecting the impact of such revisions in the related calculations under the formula, the amount of subsidy refund due from North Central for the calendar year 1962 has been determined to be $556,103.

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[8] Bonanza Air Lines, Inc., 1962 Subsidy Refund, Order E-21137, July 30, 1964.

[9] Alaska Coastal-Ellis Airlines, Mail Rates, Orders E-20790, May 5, 1964, and E-20835, May 19, 1964; Aloha Airlines, Subsidy Mail Rates, Orders E-21138, July 30, 1964, and E-21179, August 11, 1964.

Accordingly, IT IS ORDERED, That North Central Airlines, Inc., shall refund $556,103 to the Government pursuant to the provisions of Class Rate I, for the calendar year 1962.

By the Civil Aeronautics Board:

HAROLD R. SANDERSON
Secretary

(SEAL)

Portions of Order E-21227 (pp. 32-36) Incorporated by Reference in Order E-21663.

Investment tax credit—Class Rate III provides that taxes shall be determined on the basis of the carrier's actual income taxes as reported on its income tax returns, including the reduction of taxes resulting from investment tax credits derived under section 38 of the Internal Revenue Code of 1954, as amended. The specific reference to investment tax credits in no way changes the actual tax provisions as set forth in Class Rates I and II, but is intended merely to make clear our position with respect to the treatment of such credits in the light of the provisions of section 203(e) of the Revenue Act of 1964 (78 Stat. 19).

The actual tax policy is intended to insure that the Board, in determining the amount of subsidy to which a carrier is entitled, will provide an allowance for taxes which is no greater than the taxes actually paid by the carrier. Hence, in the *Western-Inland Case, supra,* the Board rejected the notion that the tax element should cover constructed taxes which the carrier *would have* paid if it had not incurred the expenses which were being disallowed for subsidy purposes. By the same token, the Board has refused to provide, in a past period subsidy case, an allowance for taxes which were deferred under the liberalized depreciation provisions of section 167 of the Internal Revenue Code of 1954, as amended, on the ground that only actual taxes are recog-

nizable.[17] In fact, in two individual subsidy cases[18] and in one profit-sharing case,[19] the Board has considered the reduction of taxes resulting from investment tax credits in making its final determinations.

On its face, the language of section 203(e) of the Revenue Act of 1964[20] may raise some question as to the application of the actual tax policy with respect to taxes saved by the carrier through investment tax credits. At first glance, the section might appear to encompass all rate-making by federal regulatory agencies (although there is doubt as to whether fixing subsidy rates for developmental purposes is "establishing the cost of service" of an air carrier), and, thus, to preclude the application of the actual tax policy to investment tax credits even in subsidy cases. However, there is nothing in the legislative history of the Revenue Act which inidcates that Congress even considered the consequences of section 203(e) in subsidy rate-making proceedings. To the contrary, the legislative history is

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[17] Reopened Pan American Mail Rate Case, (Order to Show Cause) E-18018, p. 34, February 13, 1962, (Final Order) E-18072, March 5, 1962. This case distinguished the rule applied in subsidy cases from the rule applied in commercial rate cases.

[18] Alaska Coastal-Ellis Airlines, Mail Rates, (Provisional Statement) E-20790, May 5, 1964, (Final Order) E-20835, May 19, 1964; Aloha Airlines, Subsidy Mail Rates, (Provisional Statement) E-21138, (Final Order) E-21179, August 11, 1964.

[19] Bonanza Air Lines, Inc., 1962 Subsidy Refund, Order E-21137, July 30, 1964.

[20] Section 203(e) provides:

> "It was the intent of the Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954 . . . to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use [such credit allowed under section 38 of the code] to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method."

clear that the purpose of the provision is to prevent a flow-through to "consumers" (the "customer of the utility") of the benefits of the credit, so that the utility can enjoy the incentives for improvement and expansion which the credit provides.[21] While there were isolated references in the legislative history to air carriers and the Board, they related to the flow-through concept,[22] and did not broach subsidy questions. To infer that a statute materially alters a fundamental principle of subsidy rate regulation (the actual tax policy in this case), it must clearly appear that Congress intended such an effect.[23] There is no such clear indication in section 203(e) or its legislative history.

Actually, the results intended by section 203(e) for other regulated industries and nonsubsidized airlines—that is, the encouragement of development and expansion—are already provided for subsidized airlines by section 406(b) of the Federal Aviation Act, which controls the establishment of the class rate. Section 406(b) requires the Board in fixing subsidy rates to take into consideration:

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[21] The report of the House Ways and Means Committee (H. Rept. No. 749, September 13, 1963, accompanying H.R. 8363) states clearly that ". . . [i]n the case of the investment credit the bill . . . prevents regulatory commissions in certain cases from requiring the 'flow through' of the benefits of the investment credit to the customers of regulated industries . . ." The same statement was made in Senate Report No. 830, January 28, 1964, and statements in the debate were to the same effect. *E.g.* 110 Cong. Rec. 1231 and 1439.

[22] Typical of such comments was one by Senator Long who said:

> "So far as the CAB is concerned, that regulatory agency does not fix the rates of the airline. Those rates are fixed by competition. Therefore, so far as that agency is concerned, this does not make any difference.
>
> "So there is no real reason why that agency should become involved one way or the other . . ."

Obviously, the Senator was talking about the filing with the Board of commercial rate tariffs which automatically become effective within a specified time if not suspended by the Board.

[23] See Panhandle Eastern Pipe Line Company v. Federal Power Commission, 316 F. 2d 659 (D.C. Cir., 1963), *cert. den.* 375 U.S. 881 (1963).

> "... the need of each such air carrier ... for compensation ... sufficient ... to enable such air carrier ... to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense."

In other words, Congress has provided a comprehensive scheme for fulfilling the need of air carriers for resources to maintain and continue the development of air transportation. If need has been otherwise met under this provision, which was designed to meet the special problems of the airline industry (particularly the subsidized airlines) for certain purposes, it can hardly be argued that the carriers "need" the benefit of the investment tax credit for the same purposes. The adoption of such a position would merely serve to provide the carriers with subsidy in excess of need,—that is, additional subsidy to cover taxes they do not pay—thereby contravening the provisions of section 406. In accordance with established canons of statutory construction, we prefer to read section 203(e) and section 406 as compatible, not contradictory. However, if there is a conflict between the two, it would seem that the Federal Aviation Act would control since it is the "special" or "dominant" statute which was designed to insure the maintenance and continued development of air transportation in the interest of the commerce of the United States, the Postal Service, and the national defense.

The carriers have indicated informally that they oppose the treatment of the investment tax credit stated above. If they wish to pursue this opposition, the Act and the Board's Rules of Practice afford them adequate opportunity to have any objections to this rate, including those related to the investment tax credit, considered in a formal proceeding, and, if they are not thereafter satisfied with the Board's disposition of these matters, to petition for judicial review. However, the carriers seek a departure from the traditional method of challenging rates proposed by the

Board. They request that language be included in Class Rate III which would preserve for each carrier the right to challenge the tax provision in the courts at a latter date, either in a special investment tax credit proceeding or after the provision is applied to the carrier in a future profit-sharing determination under Class Rate III. We are of the opinion that granting the carriers' request would not be consistent with the Board's Rules of Practice nor with the concept of finality of rates. Accordingly, the request is denied.

APPENDIX C

Class Rate I, Order E-16485

[34 C.A.B. 418]

UNITED STATES OF AMERICA
CIVIL AERONAUTICS BOARD

Washington, D. C.

Adopted by the Civil Aeronautics Board
at its office in Washington, D. C.
on the 7th day of March, 1961

Docket 12004

In the Matter of
Service Class Subsidy Rate Investigation

ORDER FIXING FINAL RATES

On February 16, 1961, the Board adopted Order E-16380, directing each of the parties herein to show cause why the Board should not adopt the findings and conclusions and fix, determine and publish the rates therein set forth as the fair and reasonable rates of compensation to be paid for the transportation of mail by aircraft for the period beginning January 1, 1961.

The time designated for filing notice of objection has elapsed and no notice of objection or answer to the order

[34 C.A.B. 419]

has been filed by Allegheny Airlines, Inc., Bonanza Air

Lines Inc., Lake Central Airlines, Inc., Mohawk Airlines, Inc., North Central Airlines, Inc., Ozark Air Lines, Inc., Piedmont Aviation, Southern Airways, Inc., or Trans Texas Airways.

The above-named parties have therefore waived the right to a hearing and all other procedural steps short of final decision of the Board fixing the rates.

The Board, upon consideration of the record hereby reaffirms and makes final all of the findings and conclusions set forth in the said order, except as specified below.

Upon a review of the class subsidy rate formula proposed in Order E-16330, the Board has concluded that certain changes of an editorial nature are desirable. These changes are as follows:

1. The definition of revenue plane miles in Section I A has been revised to clarify the provision regarding suspended route segments.

2. The references to "the requirements of the Act" in Sections III A(1) and III B (1) have been modified so as to refer only to reporting requirements.

3. The provision in Section III B (3) (a) regarding non-allowable expenses has been clarified.

4. The condition regarding payments to officers, directors, employees and stockholders in Section III B(3)(f) has been modified to reflect a more appropriate standard.

5. Clarifying language has been added to Section III B(3)(n) dealing with non-transport expenses.

6. The conditions regarding depreciation expenses have been made more precise. (Section III B(5)(a) and (b)).

7. The provision in Section III C(2)(h) concerning reserves has been limited to reserves other than valuation reserves.

Eight days will be provided for the filing of exceptions in the absence of which the rates set forth herein will become final automatically.

ACCORDINGLY, IT IS ORDERED, That the fair and reasonable rates of compensation on and after January 1, 1961, to be paid

Allegheny Airlines, Inc.
Bonanza Air Lines, Inc.
Lake Central Airlines, Inc.
Mohawk Airlines, Inc.
North Central Airlines, Inc.
Ozark Air Lines, Inc.
Piedmont Aviation, Inc.
Southern Airways, Inc.
Trans Texas Airways

for the transportation of mail by aircraft, the facilities used and useful therefor and the services connected therewith, between the points between which the carrier has been, is presently, or hereafter may be authorized to transport mail by its certificates of public convenience and necessity are the sum of (a) the service mail rates as heretofore and hereafter established for the carrier by Board orders pursuant to section 406(c) of the Act and (b) the subsidy rate for the carrier as set forth in the paragraphs below.

I. The subsidy rate for each carrier for each calendar month on and after January 1, 1961, shall be the rate per available seat mile determined in accordance with Appendix I (attached hereto) on the basis of the carrier's average number of revenue plane miles flown per station per day in the month; said subsidy rate to be applied to the available seat miles flown in the month, computed in accordance with the provisions and definitions set forth below.

[34 C.A.B. 420]

A. The revenue plane miles flown shall be computed on the direct airport-to-airport mileage between the

points actually served on each revenue trip operated over the carrier's routes pursuant to its flight schedules filed with the Board but exclusive of (1) trips flown as extra sections, (2) trips flown pursuant to authority of either certificates of public convenience and necessity or exemption orders issued pursuant to section 416(b) of the Act which do not include authority to transport mail or which expressly include mail authority on a non-subsidy eligibility basis and (3) trips flown over route segments which the Board has, pursuant to Part 205 of the Economic Regulations, authorized the carrier to suspend for economic (as opposed to operational) reasons or the extra mileage involved in serving a point which the Board has authorized the carrier to suspend for economic (as opposed to operational) reasons.

B. The available seat miles flown each month (rounded to the nearest thousand) shall be the product of (1) the revenue plane miles flown computed in accordance with (A) above and (2) the standard number of seats for the respective aircraft types as follows:

Aircraft Type	Standard Seats
DC-3	24
CV-240; F-27; M-202	40
CV-340; CV-440; M-404	44
CV-540	52

C. The term "station" shall be deemed to be the monthly average number of airports operated for the carrier, computed on an airport-day basis, with each airport given weight proportional to the number of days operated during the month pursuant to Board authorizations; provided, however, that any airport serving a point which the Board has authorized the carrier to suspend for economic reasons shall not be included in the computation of airports operated.

Airports served a full month shall be given a weight equal to the number of days in the month; airports served less than a full month shall be given a weight equal to the number of days service was authorized. The aggregate number of airport-days shall be divided by the appropriate number of days in the month to derive the weighted number of airports operated. The computation shall be carried out to one decimal place.

D. In computing the revenue plane miles flown per station per day for each month, the number of days in the month shall be based on the number of days in the calendar month exclusive of days on which operations are completely suspended due to a strike or similar work stoppage. On any days of partial re-

[34 C.A.B. 421]

duction of operations due to strikes or similar work stoppage, when the revenue plane miles flown by the carriers are less than 90 percent of the revenue plane miles scheduled to be flown for such days, such days shall be counted as a reduced number of days to be arrived at by multiplying the number of such days by the ratio of (1) the revenue plane miles flown on such days divided by (2) the product of the revenue plane miles scheduled to be flown on such days[1] times the system average performance factor of the carrier during the corresponding month or months of the prior year.

E. The subsidy otherwise payable to the carrier under this Section (I) above shall be reduced by the amount of any adjusted annual capital gain in accordance with the provisions set forth in Appendix B to Order E-14104, dated June 24, 1959, as such Appendix B may be amended from time to time, and said Appendix B is hereby incorporated herein by reference.

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[1] Based on the carrier's official schedules on file with the Board on the last day prior to the work stoppage.

F. The subsidy otherwise payable to the carrier under this Section (I) above shall be subject to reduction in accordance with the Profit Sharing terms and conditions specified in (II) below.

II. The annual subsidy otherwise due and payable to each carrier pursuant to (I) above, shall be subject to reduction to the extent that the carrier's earnings for calendar year 1961 and each succeeding calendar year exceed the carrier's fair and reasonable differentiated rate of return, in accordance with the provisions set forth below. In the event that this class rate terminates prior to the last day of a calendar year and is not superseded by a class rate containing profit-sharing provisions, the subsidy otherwise due and payable to each carrier pursuant to Section I for any such period of less than a calendar year shall be subject to reduction in like manner, *provided* that the results of the carrier for such period shall be adjusted to eliminate seasonal distortions.

A. Each carrier's fair and reasonable differentiated rate of return shall be the weighted average rate of return arrived at by applying rates of 21.35%, 7.5% and 5.5% to the common stock equity, preferred stock equity and debt components of recognized investment, respectively; provided that (1) the maximum rate of return computed in accordance with the preceding portion of this paragraph shall not exceed 12.75% (after applicable income taxes) and shall not be less than 9.00% (after applicable income taxes), and (2) in no event shall the fair and reasonable differentiated rate of return be less than the equivalent of three cents (after applicable income taxes) per revenue plane mile flown (in accordance with the definition of revenue plane miles flown as defined in IA, above).

B. In any case where a carrier's annual earnings (after applicable income taxes) exceed its fair and reasonable differentiated rate of return, such carrier

shall refund a portion of such profits to the extent

[34 C.A.B. 422]

indicated in the Table below to the Board as subsidy not due the carrier:

Rate of Return (After Taxes)	Percentage of Profits Refunded by Carrier
0% to D[2]	0%
D to 15%	50%
Over 15%	75%

C. In applying the Table in B above, the amounts due to be refunded to the Board in any calendar year shall be reduced by the amount of any earnings deficiency of the carrier in the two preceding calendar years (exclusive of periods prior to January 1, 1961). An earnings deficiency is defined as the amount by which the carrier's earnings (after applicable income taxes) in a calendar year are less than the fair and reasonable differentiated rate of return specified in IIA above.

III. In applying the provisions of II, above, the revenues and other income items, expenses, investment and income taxes shall be determined in accordance with the provisions of this Section III.

A. *Revenues*

1. The revenues shall be those reported by each carrier on its Form 41 reports to the Board, provided that such reports are consistent with the reporting requirements of the Act and the Board's Regulations (particularly Part 241 and the Uniform System of Accounts for Air Carriers) and that such reports reflect accounting practices consistent with the carrier's practices in reports for prior periods,

[2] D represents the fair and reasonable differentiated rate of return for each carrier as defined in IIA, above.

except in cases where the carrier has obtained Board approval for change in such accounting practices.

2. The revenues in reports not complying with 1, above, shall be adjusted to comply therewith in applying the provisions of II, above.

3. Revenues reported from non-transport activities or from transactions with affiliates shall be excluded unless the profit (after income taxes) to the carrier from such activities exceeds the fair and reasonable differentiated rate of return for the carrier for air transport operations, in which case such excess shall be utilized for the purpose of II, above. For the purpose of this entire Section III, the term affiliate (or affiliated) shall be deemed to include any "associated company" as defined at page 31.2 of the Uniform System of Accounts or any relationship defined as "affiliated" in Part 261.8(b) of the Board's Economic Regulations, as amended.

B. *Operating Expenses*

1. The operating expenses shall be those reported by each carrier on its Form 41 reports to the Board *provided* that such reports are consistent with the reporting requirements of the Act and the Board's Regulations (particularly Part 241 thereof and the Uniform System of Accounts) and that such reports reflect accounting practices consistent with the carrier's accounting in previous periods, except in cases where the carrier has obtained Board approval for change in such accounting practice, and *provided* further that reporting and accounts not complying with this paragraph 1 shall be adjusted to comply therewith in applying the provisions of II, above.

2. The operating expenses otherwise reported or determined in accordance with paragraph 1, above, shall be subject to the conditions set forth below.

[34 C.A.B. 423]

3. *Non-allowable expenses*—The following operating expense items shall not be recognized and shall be disallowed:

a. Any reported expense prohibited by the Act, or any other provisions of law, or regulation of the Board or other agency of Government;

b. Fines or other similar penalties accrued, or paid, as the result of violation of law or in violation of any association rule or by-law;

c. All financing costs and costs related to financing;

d. Lobbying costs;

e. Compensation, in any form whatsoever, paid directly or indirectly to or on behalf of any officer, director, or employee, of the carrier in excess of $25,000 per annum;

f. Any payment made directly or indirectly, in any form whatsoever, to or on behalf of any officer, director or employee of the carrier, or to or on behalf of any stockholder owning in excess of a 1 percent stock interest, to the extent that such payment exceeds the reasonable value of the goods or services received;

g. Any payment to directors, officers, or employees in the nature of bonuses related to profits or representing a sharing of profits;

h. Any form of dues (including initiation fees) expenses on behalf of the carrier or any officer or director, unless such dues are for membership in a business, professional or trade organization;

i. Any self-insurance or other accruals requiring Board approval of the basis of accrual, unless

approved by the Board or by the Board's staff under delegated authority;

j. Expenses incurred and accrued for proceedings in which the carrier is an unsuccessful applicant for an exemption or route award, or is an intervenor; *Provided* further that during its prosecution of an exemption or route award expenses incurred by the carrier for that purpose shall be held in suspense, for the purpose of this order, pending final decision of the Board, and if the carrier receives an award thereunder the expenses related to the carrier's successful prosecution of its case shall be recognized by amortization over a period of 5 years or the period of the award, if shorter, such amortization to commence as of the date of institution of the service provided pursuant to the Board's final decision in the exemption or route proceedings;[3]

k. Expenses in proceedings before the Board for witnesses other than the carrier's personnel or consultants hired by the carrier;

l. Contributions on behalf of the carrier for charitable or similar purposes;

m. Premiums for life insurance on the life of any officer, director or employee where the company is a named beneficiary;

n. Expenses incurred in non-transport activities and any other expense which is not reasonably related to the air transport services of the carrier, except to the extent that such expenses are offset against revenues from such activities in accordance with III A 3 above.

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[3] In cases covered by this proviso clause where the Board prior to January 1, 1961, has established a final subsidy rate which would otherwise be applicable on and after January 1, 1961, amortization shall be recognized as per such final rate order.

4. The following expenses shall be recognized to the extent indicated:

[34 C.A.B. 424]

a. Expenses incurred by the carrier in dealings with an affiliate (including a separately operated division) shall be recognized only to the extent that the charges by the affiliate are at cost, including a proper share of overhead and a capital cost not exceeding the level of the air carrier's own fair and reasonable differentiated rate of return;

b. Costs which result from transactions not at arms length, dealings involving conflicts of interest, or involving fraud on the part of the air carrier, its personnel or any person under the carrier's control shall be recognized only to the extent that such costs do not exceed reasonable levels;

c. In case the carrier enters into a sale of equipment, with a provision for lease-back of such equipment or similar equipment, any cost exceeding that which would have been incurred had such sale and lease-back not occurred will not be recognized.

5. The DEPRECIATION EXPENSE to be recognized for flight equipment (including hulls and all related flight components) shall be subject to the following additional special rules and conditions:

a. For flight equipment acquired and placed into service prior to January 1, 1961, the recognizable expense shall be based on the book value recorded as of December 31, 1960, plus any betterment or improvements subsequent to that date, provided that such value does not exceed the depreciated original cost including betterments or improvements, of such equipment to the air carrier;

b. For flight equipment acquired and placed into service on or after January 1, 1961, the recognizable expense shall be based on the depreciable original cost of such equipment (including betterments or improvements and capitalized interest) to the air carrier;

c. The service lives and residual values for flight equipment (including hulls and all related components) shall be as set forth in the following table:

Equipment type	Service life	Residual value
DC-3	3 years	10%
all other piston-powered aircraft	7 years	15%
turbine-powered aircraft	10 years	15%

d. The service life for each aircraft type shall be deemed to commence as of the date of its introduction into regularly scheduled service, provided that the remaining service life for aircraft placed into service prior to January 1, 1961, shall be computed by subtracting from the years of service life set out in the table above the periods prior to January 1, 1961, for which depreciation has been accrued by the air carrier for such flight equipment, and the remainder of the depreciable value so derived shall be spread out equally each month from January 1, 1961 forward;[4]

e. For the purpose of this paragraph 5, the otherwise recognizable depreciable cost for aircraft hulls and engines shall be reduced by the value of the so-called "built-in-overhaul," such value to be determined at a reasonable level consistent with prior and anticipated experience; *Provided,* however, that where aircraft are maintained on

[4] Where a final rate has been established for the carrier prior to January 1, 1961, the "remaining service life" shall be based on the depreciation rates recognized in such final order (or orders).

a phase or pattern overhaul basis, the depreciable cost shall be reduced by only 50 percent of the value of the "built-in-overhaul" plus the value of the hours remaining to the next phase or pattern overhaul; *Provided* further that maintenance

[34 C.A.B. 425]

charges will be recognized consistent with the built-in-overhaul principle, and that accruals to a reserve for future overhauls will not be recognized.

C. *Investment*

1. Subject to the same requirements as to compliance with the Act and the Board's Regulations, as set forth in A and B, above, the investment shall be the average of the balance sheets reported for the four quarters of the calendar year, for which Section II, above, is being applied, and the year end balance sheet for the immediately preceding year, with one-half weight accorded the opening and closing balance sheets.

2. The investment shall be subject to the additional special rules and conditions set forth below:

a. Notes payable due beyond 90-days shall be treated as long-term debt;

b. Non-operating property shall be excluded;

c. The air carrier's investment in any affiliated or non-transport activity shall be recognized only in the event that the profits (after income taxes) reported by the air carrier from such company or activity exceed the fair and reasonable differentiated return of the air carrier and such profits are utilized to reduce the air carrier's subsidy;

d. The investment shall not include the cash or other value of any life insurance policy covering any company executive;

e. The investment shall not include equipment replacement funds derived from sale of flight equipment, but such funds shall be recognized only when re-invested in property which is productive in the carrier's transport operations;

f. The investment shall not include equipment purchase deposits, capitalized organizational expense, capital stock expense, unamortized discount and expense on debt, and/or special funds such as sinking funds as specified in Account 1550 in the Uniform Manual of Accounts;

g. Working capital in excess of the equivalent of 3 month's operating expenses, exclusive of depreciation and amortization, shall be excluded;

h. Reserves accrued through charges to operating expense (except depreciation, airworthiness and other valuation reserves) will be treated as a current liability for the purpose of this paragraph C;

i. Construction work in progress shall be recognized only to the extent that capitalized interest on such item is not claimed by the carrier;

j. The computation of working capital related to periods prior to January 1, 1961 shall reflect the subsidy payable to the air carrier pursuant to the most recent Board order dealing with the carrier's subsidy for such period, but for periods commencing January 1, 1961, accruals for each balance sheet date shall be made pursuant to the rate established by this Order.

[34 C.A.B. 426]

D. *Other Income and Non-operating Expenses*—In applying Section II, above, all income to the carrier (other than capital gains on flight equipment qualifying pursuant to Section 406(d) of the Act and the Board's

Regulations thereunder) shall be included whether such income is recorded as revenue, non-operating income and/or Special Income; but only the following classes of non-operating expenses shall be recognized:

1. Capital losses on ground equipment; and

2. Non-routine foreign exchange adjustments.

E. Where an adjustment is required and effected pursuant to the provisions of paragraph III A or B or C or D above, such appropriate adjustments shall be made for the purpose of all other provisions of this Section III where sound accounting practice and consistency so require.

F. *Income Taxes*—Federal and State income taxes shall be determined on the basis of the carrier's income tax returns for each year as submitted to the taxing authorities, with such amendments or revisions (including tax carry-back and carry forward credits) as may have been filed as of the date of the final determination of excess profits (or an earnings deficiency) under this Order, *Provided,* however, that for carriers whose tax returns are filed for a 12 month period not coinciding with a calendar year, a *pro forma* tax return will be required to be submitted for the calendar year, which return shall be prepared on bases consistent with the returns of that carrier filed for the latest fiscal year year with the appropriate tax authorities.[5]

G. The refund otherwise due and payable to the Government pursuant to Section II shall be increased by the amount of the income tax savings estimated to accrue to the carrier as the result of such refund.

It is Further Ordered, That the compensation provided herein shall be in lieu of, and not in addition to, the mail

[5] A reconciliation of such *pro forma* return with the carrier's reported operating results will be required.

compensation heretofore received by the carriers named above for mail transportated over their entire systems on and after January 1, 1961.

IT IS FURTHER ORDERED, That this order shall become effective on the eighth day after the date of service unless prior to that date exceptions (with respect to the changes described on pp. 1 & 2 hereof) and supporting reasons have been filed with the Board by any party named above. If exceptions and supporting reasons are filed within the prescribed time, the effective date of this order shall be stayed pending disposition of the exceptions.

By the Civil Aeronautics Board:

/s/ ROBERT C. LESTER
Robert C. Lester
Secretary

(SEAL)

LOCAL SERVICE CLASS SUBSIDY RATE

Rate per Available Seat Mile at Density Factors Ranging from 300 to 600 Revenue Plane Miles per Station per Day

Density Factor	Rate	Density Factor	Rate	Density Factor	Rate	Density Factor	Rate	Density Factor	Rate	Density Factor	Rate
300[a]	3.1100¢	325	2.9600¢	350	2.8100¢	375	2.6600¢	400	2.5100¢	425	2.3600¢
301	3.1040	326	2.9540	351	2.8040	376	2.6540	401	2.5040	426	2.3540
302	3.0980	327	2.9480	352	2.7980	377	2.6480	402	2.4980	427	2.3480
303	3.0920	328	2.9420	353	2.7920	378	2.6420	403	2.4920	428	2.3420
304	3.0860	329	2.9360	354	2.7860	379	2.6360	404	2.4860	429	2.3360
305	3.0800	330	2.9300	355	2.7800	380	2.6300	405	2.4800	430	2.3300
306	3.0740	331	2.9240	356	2.7740	381	2.6240	406	2.4740	431	2.3240
307	3.0680	332	2.9180	357	2.7680	382	2.6180	407	2.4680	432	2.3180
308	3.0620	333	2.9120	358	2.7620	383	2.6120	408	2.4620	433	2.3120
309	3.0560	334	2.9060	359	2.7560	384	2.6060	409	2.4560	434	2.3060
310	3.0500	335	2.9000	360	2.7500	385	2.6000	410	2.4500	435	2.3000
311	3.0440	336	2.8940	361	2.7440	386	2.5940	411	2.4440	436	2.2940
312	3.0380	337	2.8880	362	2.7380	387	2.5880	412	2.4380	437	2.2880
313	3.0320	338	2.8820	363	2.7320	388	2.5820	413	2.4320	438	2.2820
314	3.0260	339	2.8760	364	2.7260	389	2.5760	414	2.4260	439	2.2760
315	3.0200	340	2.8700	365	2.7200	390	2.5700	415	2.4200	440	2.2700
316	3.0140	341	2.8640	366	2.7140	391	2.5640	416	2.4140	441	2.2640
317	3.0030	342	2.8580	367	2.7080	392	2.5580	417	2.4080	442	2.2580
318	3.0020	343	2.8520	368	2.7020	393	2.5520	418	2.4020	443	2.2520
319	2.9960	344	2.8460	369	2.6960	394	2.5460	419	2.3960	444	2.2460
320	2.9900	345	2.8400	370	2.6900	395	2.5400	420	2.3900	445	2.2400
321	2.9840	346	2.8340	371	2.6840	396	2.5340	421	2.3840	446	2.2340
322	2.9780	347	2.8280	372	2.6760	397	2.5280	422	2.3780	447	2.2280
323	2.9720	348	2.8220	373	2.6700	398	2.5220	423	2.3720	448	2.2220
324	2.9660	349	2.8160	374	2.6660	399	2.5160	424	2.3660	449	2.2160

[a] The rate of 3.1100¢ applies to density factors up to 300.

[Appendix I of Class Rate Order].

Density Factor	Rate	Density Factor	Rate	Density Factor	Rate	Density Factor	Rate	Density Factor	Rate	Density Factor	Rate
450	2.2100¢	475	2.1400¢	500	2.0700¢	525	2.0000¢	550	1.9300¢	575	1.9150¢
451	2.2072	476	2.1372	501	2.0672	526	1.9972	551	1.9294	576	1.9144
452	2.2044	477	2.1344	502	2.0644	527	1.9944	552	1.9288	577	1.9138
453	2.2016	478	2.1316	503	2.0616	528	1.9916	553	1.9282	578	1.9132
454	2.1988	479	2.1288	504	2.0588	529	1.9888	554	1.9276	579	1.9126
455	2.1960	480	2.1260	505	2.0560	530	1.9860	555	1.9270	580	1.9120
456	2.1932	481	2.1232	506	2.0532	531	1.9832	556	1.9264	581	1.9114
457	2.1904	482	2.1204	507	2.0504	532	1.9804	557	1.9258	582	1.9108
458	2.1876	483	2.1176	508	2.0476	533	1.9776	558	1.9252	583	1.9102
459	2.1848	484	2.1148	509	2.0448	534	1.9748	559	1.9246	584	1.9096
460	2.1820	485	2.1120	510	2.0420	535	1.9720	560	1.9240	585	1.9090
461	2.1792	486	2.1092	511	2.0392	536	1.9692	561	1.9234	586	1.9084
462	2.1764	487	2.1064	512	2.0364	537	1.9664	562	1.9228	587	1.9078
463	2.1736	488	2.1036	513	2.0336	538	1.9636	563	1.9222	588	1.9072
464	2.1708	489	2.1008	514	2.0308	539	1.9608	564	1.9216	589	1.9066
465	2.1680	490	2.0980	515	2.0280	540	1.9580	565	1.9210	590	1.9060
466	2.1652	491	2.0952	516	2.0252	541	1.9552	566	1.9204	591	1.9054
467	2.1624	492	2.0924	517	2.0224	542	1.9524	567	1.9198	592	1.9048
468	2.1596	493	2.0896	518	2.0196	543	1.9496	568	1.9192	593	1.9042
469	2.1568	494	2.0868	519	2.0168	544	1.9468	569	1.9186	594	1.9036
470	2.1540	495	2.0840	520	2.0140	545	1.9440	570	1.9180	595	1.9030
471	2.1512	496	2.0812	521	2.0112	546	1.9412	571	1.9174	596	1.9024
472	2.1484	497	2.0784	522	2.0084	547	1.9384	572	1.9168	597	1.9018
473	2.1456	498	2.0756	523	2.0056	548	1.9356	573	1.9162	598	1.9012
474	2.1428	499	2.0728	524	2.0028	549	1.9328	574	1.9156	599	1.9006
										600[b]	1.9000

[b] The rate for density factors above 600 shall be computed by multiplying the rate of 1.9000¢ by the ratio of 600 to such density factors above 600.

REPLY BRIEF FOR PETITIONER

IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,209

NORTH CENTRAL AIRLINES, INC.,
Petitioner,

v.

CIVIL AERONAUTICS BOARD,
Respondent.

On Petition for Judicial Review of an Order of the Civil Aeronautics Board

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REPLY BRIEF FOR PETITIONER

I. Respondent's Objections To the Court's Jurisdiction Are Without Merit.

Respondent argues that the Court lacks jurisdiction because the order under review was not an "order" within the meaning of section 1006 of the Federal Aviation Act. Respondent appears to acknowledge that orders are judicially reviewable if they:

> ". . . impose an obligation, deny a right, or fix some legal relationship as a consummation of the administrative process." *Chicago and Southern Air Line, Inc.* v. *Waterman S.S. Corp.*, 333 U.S. 103, 112 (1948)[1]

Although Order E-21663 commands Petitioner to pay money, and bears all the other indicia of a reviewable order, Respondent alleges that it should not be construed as an "order" but should fall within the holding of *Mohawk Airlines* v. *Civil Aeronautics Board*, 117 U.S. App. D.C. 326, 329 F. 2d 894 (1964). That case held that a letter signed by the Chairman of the Civil Aeronautics Board was not a reviewable order for two reasons: (1) It did not purport to be an order; and (2) it was not issued *under* the Federal Aviation Act.

Respondent argues for applicability of the *Mohawk* case despite the fact that it there relied on distinctions which it now overlooks. In that case the *prima facie* difference between the letter and an order were emphasized, as was the fact that the letter "commanded no action by Petitioner" (See: Respondent's Brief in *Mohawk Airlines* v. *C.A.B.*, No. 17,986, p. 12). Those very distinctions establish that the *Mohawk* opinion does not apply to this case.

A. *Respondent's order purports to be an order. The surrounding circumstances do not establish it to be other than what it purports to be.*

At issue in this case is an order commanding payment. At issue in the *Mohawk* case was a letter expressing an intent to offset. It is true that a difference in form does not necessarily connote a difference in legal effect. However, by the same token it takes something more than

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[1] See, also, *United States* v. *Los Angeles & S. L. R. Co.*, 273 U.S. 299 (1927); *United States* v. *Illinois Central R. Co.*, 244 U.S. 82 (1916).

Respondent's after the fact characterization to convert a *prima facie* order into a non-order.[2]

Respondent states that its established practice (a "consistently followed interpretation of its own orders") should be relied on by the Court in determining the true nature of its action. It alleges that it has "not in the past treated profit sharing determinations as having the conclusory, mandatory force of orders * * * under the Act." (Resp. Brief, p. 15) The propositions cited by Respondent do not, however, establish that claim:

(1) Respondent's admitted refusal to hold hearings on profit sharing determinations and to treat these determinations as rate making does not establish that these profit sharing orders are not mandatory. Orders are issued by Respondent which involve neither hearings nor

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[2] It is true, as Respondent notes, that in some cases agency statements purporting to be orders or issued with full formalities have been held *not* to be judicially reviewable. However, none of the authorities cited support the proposition that an order to refund money is not reviewable. *United States* v. *Los Angeles & S. L. R. Co.*, 273 U.S. 299 (1927), the first case cited by Respondent, involved an agency action described as follows:

> "The so-called order here complained of is one which does not command the carrier to do, or to refrain from doing, anything; which does not grant or withhold any authority, privilege, or license; which does not extend or abridge any power or facility; which does not subject the carrier to any liability, civil or criminal; which does not change the carrier's existing or future status or condition; which does not determine any right or obligation." 273 U.S. at 309-310.

American President Lines, Ltd. v. *Federal Maritime Com'n.*, 114 U.S. App. D.C. 418, 421, 316 F. 2d 419, 421 (1963) involved an order of "no independent binding effect." In *California Oregon Power Co.* v. *Federal Power Com'n.*, 99 U.S. App. D.C. 263, 270, 239 F. 2d 426, 433 (1956) it was noted that the Commission's action had no "positive effect on the complainant." In *Helco Products Co.* v. *McNutt*, 78 U.S. App. D.C. 71, 137 F. 2d 681 (1943) the Court agreed that a declaratory judgment action did not lie on the basis of an agency's advisory opinion. No order had been issued and no steps taken to put any administrative program into action.

rate making and yet are reviewable by this Court.[3] Nor can the absence of full procedural formalities determine reviewability.[4]

(2) Respondent has never expressly or by implication stated that no penalties would be involved for failure to comply with a profit sharing order. Nor has it ever indicated that such orders were not issued under the Federal Aviation Act. The fact that carriers have not been threatened with penalties for failure to refund does not establish that Respondent had waived its power to invoke penalties. Enforcement action has never been required because of the possibility of offsetting amounts due against continuing subsidy payments.

If Respondent has been consistently construing its orders in the manner alleged, it has been a well kept secret. Regardless, it must not now be permitted to rely on its undisclosed views to establish this Court's lack of jurisdiction.[5]

The difficulty of Respondent's argument goes beyond its failure to disclose its views on enforceability. Respondent's profit sharing determinations could readily have

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[3] See e.g., *Nebraska Dept. of Aeronautics* v. *Civil Aeronautics Board*, 298 F. 2d 286 (8th Cir. 1962) (suspension of service); *Capitol Airways, Inc.* v. *Civil Aeronautics Board*, 112 U.S. App. D.C. 48, 292 F. 2d 755 (D.C. Cir. 1961) (revocation of exemption authority); *Flying Tiger Line* v. *Civil Aeronautics Board*, Civil No. 18859, U.S. App. D.C., June 17, 1965 (refusal to investigate complaint).

[4] See, *Mid Valley Distilling Corporation* v. *DeCarlo*, 161 F. 2d 485 (3d Cir. 1947) (Cited in Respondent's Brief, note 17).

[5] If an agency is permitted to announce its consistently followed interpretation after an action is commenced, there is obviously a great temptation to portray history in terms which suit the jurisdictional question at hand. Petitioner suggests that, where an agency seeks to deny the plain import of its orders, it must show that the interpretation it relies upon was not only consistently followed but clearly evident.

been made in the same manner as was done in the *Mohawk* case—by letter announcing an intent to offset. It is not unreasonable to assume that the decision *not* to use the *Mohawk* technique was that it sought different legal consequences. Certainly the reason given by Respondent, that there is more "general interest" in profit sharing determinations, does not account for the use of a formal order.[6]

It accounts even less for the terms of the order, which was directed at Petitioner. An order could have been directed to Respondent's staff, as many orders are. It could have stated:

> "*It is ordered* that the amount of $556,103 shall be deducted from future subsidy payments to North Central Airlines, Inc."

Without conceding that such language would have obviated this Court's jurisdiction, it clearly would have been more consistent with Respondent's characterization of its intent.

The form of the order is more than a meaningless happenstance. By directing an order to the carrier, Respondent obtained advantages which the mere announcement of its profit sharing calculation would not afford. First, it obtained the coercive effect of sections 901 and 902 of the Federal Aviation Act, 49 U.S.C. 1471, 1472 (civil and criminal penalties). Second, in the event Respondent were unable to collect the amount, the order permitted it to

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[6] Respondent suggests that it resorted to an order here because "profit sharing determinations under the class rate are considered to be of greater general interest" than the determination in the *Mohawk* case (Resp. Brief, p. 15). Respondent has many means available other than formal orders to make known determinations of general interest. For example, where it wishes to make known its views on international rate discussions, it simply writes a letter to the U.S. carriers involved, reproduces that letter, and gives it wide public distribution.

avail itself of section 1007 of the Federal Aviation Act, 49 U.S.C. 1487, which provides for judicial enforcement of its orders, a procedure perhaps preferable to a civil action to recover the amount due.

It is true, of course, that as long as Respondent had available the means of offsetting the refund due against future subsidy, it need not have been greatly concerned with its enforcement powers. The chances were indeed remote that Petitioner would go out of business or have no further subsidy need prior to the Respondent's offsetting the amount due. Small as that risk was, Respondent elected to guard against it by framing a mandatory order. The important point is not whether it was necessary to issue a mandatory order but whether Respondent did so. Having invoked its power to compel, Respondent may not now avoid the accompanying consequences.

B. *The Order was issued under the Federal Aviation Act.*

Respondent characterizes its order as one under section 322 of the Transportation Act and hence not under the Federal Aviation Act. This involves a strained statutory construction and results in a completely inconsistent approach from that taken by Respondent in its argument on applicability of the tax credit. When arguing that subsidy is covered by a section of law dealing with "government traffic" under "tariffs lawfully on file" (section 322), Respondent suggests a close similarity between subsidy and other commercial rates. But when interpreting section 203(e) of the 1964 Revenue Act, Respondent argues that the differences "are far more fundamental" than the similarities (Resp. Brief, p. 30). Respondent's flexible approach throws doubts on its position as to both pieces of legislation.

Petitioner maintains that since Respondent had no power to make an offset under section 322 of the Trans-

portation Act, its order could not have been issued thereunder. Since Respondent has no common law power to issue orders,[7] its order must have been issued under the Federal Aviation Act. However, it is unnecessary for the Court to decide the question of whether section 322 applies here. Respondent's order, unlike its letter in the *Mohawk* case, makes no mention of offset.[8] Nor does it anywhere indicate reliance on section 322 of the Transportation Act. These omissions, plus the use of an order instead of a letter, cannot have been unconscious. Plainly Respondent chose not to act pursuant to the *Mohawk* approach but pursuant to its conventional statutory authority, the Federal Aviation Act. The order so purports and this Court need not go behind it.[9]

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[7] Accepting, *arguendo*, Respondent's claim that it has a common law right of offset, that right is different from the right to issue orders commanding payment, which does not derive from the common law.

[8] The letter to Mohawk concluded:

> "Accordingly, we intend to make an offset of $18,204.16 against your next regular monthly subsidy payment." 117 U.S. App. D.C. at 328, 329 F.2d at 896.

[9] In a footnote to its jurisdictional argument, Respondent makes the further objection to review by this Court on the grounds that there is an absence of a proper appellate record. Principal reliance is placed on *United Gas Pipe Line Co.* v. *Federal Power Com'n.*, 86 U.S. App. D.C. 314, 181 F.2d 796, 799 (1950), *cert. denied* 340 U.S. 827 1950. This view is factually and legally unsupportable. First, there is a record in this case; a great deal of it is in the Joint Appendix. It consists in part of financial statements submitted to the Board under its reporting regulations, and the special financial statements (Form T-88) submitted in connection with the profit sharing calculation. Second, the *United Gas* case involved a *rule* of *future* applicability. The Court, quoting from *American Sumatra Tobacco Corp.* v. *Securities and Exchange Com'n.*, 68 U.S. App. D.C. 77, 80, 93 F.2d 236, 239 (1937), specifically noted that it would not hesitate to take jurisdiction if an administrative action operated "particularly rather than generally . . . [and was] a judgment entered on a state of facts and affecting only one person." 68 U.S. App. D.C. at 317, 181 F. 2d at 799.

II. Respondent's Analysis of Legislative Intent Ignores the Numerous Indications By Congress That It Intended the Investment Credit To Be Retained By *All* Regulated Companies, Including Subsidized Companies.

Respondent's conclusion as to the intent of Congress in sections 38 and 203(e) suffers from a basic defect. It overlooks the fact that the investment tax credit provisions are of general, not limited, applicability. If the statutes at issue involved solely the safeguarding of a tax credit for regulated industry, it could more reasonably be argued that the right to keep the benefit of the credit should not by implication be extended to *subsidized* regulated industry. But where, as here, the intended coverage is *all* industry, the more natural conclusion is that *no* exceptions are to be implied and selectivity was *not* intended.[10] The legislative history confirms this view.

A. *The legislative history of section 38 shows that Congress intended the tax credit to be available to all, including subsidized companies.*

The investment tax credit is available for the acquisition of any so-called "section 38 property". Such property, as defined in the Act, consists of all "tangible personal property" with certain specified exceptions.[11] These exceptions consist principally of (1) certain property used outside the United States, (2) property used for lodging, (3) property used by governmental units and certain tax exempt organizations, and (4) livestock. 26 U.S.C. 48 (a). Under the doctrine of *expressio unius est exclusio alterius* the fact that this property was specifically excluded shows a clear intent to *include* all other tangible personal property.

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[10] Exceptions may not be read into a statute that is plain on its face. *Stuyvesant Ins. Co. of New York* v. *Nardelli*, 286 F. 2d 600 (5th Cir. 1961); *De Freese* v. *United States*, 270 F.2d 730 (5th Cir. 1959), *cert. denied* 362 U.S. 944 (1960).

[11] Certain other tangible property is also included. 26 U.S.C. 48(a).

This intent is underscored by arguments made by opponents of the tax credit who pointed out the numerous disadvantages of a shotgun statute. For example, Senator Proxmire, an opponent of the tax credit, made this observation in a speech placed in the Congressional Record:

> "In addition, it should be realized that, while the purposes of the investment credit is to stimulate economic growth and help business to compete more effectively in foreign markets, *it would in fact be given all the way across the board without regard to the quality or social need for the investment.* Thus the credit would be available for such investments as a new ski lift at Sun Valley or in Vermont, an escalator in a department store, new farm machinery to spread fertilizer on lands which are already over producing, kleig lights in a burlesque house, and martini mixing machines in a bar. Other investments of an even more questional nature would receive the bonus." 108 Cong. Rec. 17780 (Emphasis added)

The question of a tax credit for federally subsidized carriers also came up specifically. The Administration's tax credit proposal would have excluded "the subsidized merchant marine".[12] Neither the House nor Senate accept-

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[12] Secretary Dillon stated:

> *"The proposal would, however, apply to enterprises in the transportation field (other than the subsidized merchant marine)* which, although subject to various forms of regulation of their charges, are in fact highly competitive businesses with varying rates of return on investment. This group would include railroads, airlines, truck and bus operators, and other types of public carriers. Many of these enterprises are not only competitive among themselves at given regulated prices, but also must compete with private truck fleets, private airplanes, and other transportation facilities operated by industrial corporations which would be eligible for the credit." Hearings of House Way and Means Committee on the Tax Recommendations of the President pursuant to his message of April 21, 1961, 87th Cong. 1st Sess. Vol. 1, p. 257 (emphasis added)

ed this restriction.[13] In House debate Congressman Alger, a minority member of the Ways and Means Committee, pointed out:

> "For example, the Government already subsidizes 50% of the cost of construction of U.S. flag ships. The President's budget shows expenditures under this program for fiscal 1963 amounting to $122 million. Yet this bill provides additional subsidy of 7 percent for each and every subsidized vessel built in the United States." 108 Cong. Rec. 5339.

These objections were of no avail, and the tax credit is now available to shipping companies no matter how heavily subsidized they may be.

B. *The language and legislative history of section 203(e) make clear that Congress wanted to avoid selective application of the benefit of investment tax credit.*

Congress found it necessary to enact section 203(e) because the regulatory agencies would not take it at its word. The benefits of section 38 were intended to be generally and uniformly available. But shortly after enactment of that section, two regulatory agencies concluded that Congress could not have intended to risk "tax windfalls" and they attempted to bar retention of the benefit by appropriate means.

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[13] The disposition of Congress to grant *broader* coverage than proposed by the Administration is indicated by the inclusion of a 3% tax credit for public utility property (e.g., electric, gas, water, telephone) where the Administration had proposed complete exclusion of such property (Hearings, *supra*, p. 256), and where at least one major utility (AT&T) had *opposed* the credit. *Id.*, p. 1126 *et. seq.*

The purpose of Congress in enacting section 203(e) was to close a gap which these regulatory decisions had begun to open. The following reasons clearly demonstrate that, in closing the gap, Congress did not intend to leave out subsidized airlines.

First, the language of section 203(e) is extremely broad. It applies to *all* agencies of the United States and to *all* private industry. Section 203(e) was not, as Respondent seems to view it, a new addition to existing coverage. It was a second effort to achieve complete coverage.[14] Thus the issue is not where the added piece was intended to be cut off, but whether the original blanket is supposed to have a hole in the center.

Second, there is no basis at all in the legislative history for implying an exception for subsidized airlines. Senator Long, the floor manager, repeatedly emphasized the concept of blanket coverage. Citing the Conference Report on the 1962 Act (which specified that the credit should be available to "regulated and non-regulated" industries), the Senator pointed out:

> "The legislative history in the House is clear. The House intended *all* industry to get it. 110 Cong. Rec. 2085 (Emphasis added)[15]

Elsewhere in the Senate debate he pointed out:

> "The proposal would treat *all carriers alike*. They would *all* receive the benefit of the 7 percent tax credit." 110 Cong. Rec. 2079 (Emphasis added)

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[14] Section 203(e) does not grant a tax credit. Rather, it prohibits the nullification of the existing credit. It is directed, not at the industry which is to benefit, but at the agencies which would deny the benefit.

[15] Thereafter, as Senator Long pointed out, the Conference adopted the House position and Senator Kerr, who had made a contrary statement "undertook to conform his legislative declarations of those of the House Conferees." 110 Cong. Rec. 2085.

This was no irrational insistence on uniformity. Secretary Dillon had pointed out that many regulated industries are highly competitive with non-regulated industries and deserved equal access to the tax incentive. (supra, note 12) Senator Long took the same view:

> "I shall state my position very clearly: I do not think Congress should do these things for one industry and not do them for the competitors of that industry." 110 Cong. Rec. 2072.

As noted in Petitioner's opening brief (pp. 27-28), Respondent's view of the law would result on precisely the competitive inequality Congress sought to avoid.

III. The Principle of Rate Finality Does Not Authorize Respondent To Deny the Benefit of the Tax Credit.

A. *It was not necessary to change the class rate to conform to the intent of Congress.*

Respondent's elaborate argument about rate finality and the applicability of its "actual tax policy" poses a question which the Court need not reach. The class rate is not a conventional rate but a formula. It is open-ended in the sense that it does not state what specific amount the carrier will be paid or what amount of taxes or other costs shall be considered in the profit sharing determination. Those amounts depend on the carrier's earnings and on the applicable tax laws. Such applicable laws include, as we have previously pointed out, section 203(e).[16]

The amount of profit to be shared is derived from the revenues, expenses, and taxes shown by the carrier's ac-

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[16] The concept of a rate which future legislation may affect is illustrated elsewhere in Class Rate I. One "non-allowable" expense for profit sharing is "any reported expense prohibited by the Act, or any other provision of law, or regulation of the Board or other agency of government". *Local Service Class Subsidy Rate*, 34 C.A.B. 416, 423 (1961). Thus changes in law or regulations may make an expense unallowable *after* the rate has become final.

counts. What the accounts show depends in part on the accounting reports prescribed by Respondent. The method of reporting any item may be changed by Respondent without changing the finality of rate. Yet it may affect the amount of profit shared.[17] If Respondent's directives as to account reporting may affect the profits shared, it is difficult to understand why the directive of Congress may not.[18]

B. *If a change in the rate was necessary, it was Respondent's obligation to make it.*

Respondent's argument that it cannot retroactively change a rate is simply another attempt to escape the clear intent of Congress. The statutes and legislative history clearly show that Congress desired that the credit be available to *all*, that it desired the credit to be effective retroactively[19], and that regulatory agencies were not to interfere with the retention of the credit *"by any other method."* (Sec. 203(e)). The fact that Congress did not specifically express a wish to have existing rates modified establishes nothing. Congress did not address itself to

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[17] The class rate specifically provides that revenues and expenses are to be:

> ". . . those reported by each carrier on its Form 41 reports to the Board provided that such reports are consistent with the reporting requirements of the Act and the Board's Regulations (particularly Part 241 thereof and the Uniform System of Accounts) and that such reports reflect accounting practices consistent with the carrier's accounting in previous periods, except in cases where the carrier has obtained Board approval for change in such accounting practice . . ." 34 C.A.B. at 422.

[18] At the minimum, Congress' directive in section 203(e) goes to accounting treatment. The FCC and FPC proceedings which initially prompted section 203(e) were concerned with the method of accounting for the tax credit.

[19] The Senate bill proposed retroactivity to June 30, 1962, but the Conference set the date back to December 31, 1961, as the House Bill had provided. See: remarks of Senator Kerr, 108 Cong. Rec., 21708.

any specific provision of law or policy in conflict with its aims. It merely made clear that *all* law or policy which conflicted with the retention of the benefit tax credit by regulated industries had to give way. It is difficult to understand how that broad and pointed directive of Congress can be made subservient, by an arm of Congress, to a rate which does not even refer to the investment tax credit.[20]

If Respondent is dissatisfied with Congress' policy, it is not without remedy. It is free now, as it was during Congress' consideration of sections 38 and 203(e), to express its views and invite Congress to legislate a specific provision for subsidized air carriers.[21] That course of action would be far more appropriate than direct flouting of existing law, as reflected in the order under review, and this Court is respectfully urged to so indicate.

IV. An Early Decision Is Requested In Order To Avoid Further Harm From Respondent's Erroneous Interpretation of the Law.

The presently applicable class rate (Class Rate III), which took effect July 1, 1964, deals specifically with the

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[20] If Respondent thought there was a conflict between the Statute and its rate, it, not Petitioner, was under an obligation to change the rate. As noted, Petitioner does not share the view that a change in the rate was necessary to carry out the purpose of Congress.

[21] In its Brief Respondent adverts to the subsidy paid Petitioner by characterizing it as "extremely generous". The amount of subsidy earned is the amount Respondent has found Petitioner "needs" within the meaning of section 406(b) of the Federal Aviation Act, and it can be assumed that the amount is not regarded by Respondent as excessive or it would have changed the rate as required by the statute. Petitioner regrets that its route system is too weak to be self-supporting. That being the case, however, Petitioner responds, as do all local service carriers, as best it can to the incentives provided by the subsidy rate. The results may vary widely from carrier to carrier and year to year. Clearly however, those results, whatever they may be, do not establish the correctness of Respondent's interpretation of a tax statute.

investment tax credit and calls for its recapture in profit sharing. By Order E-21227, August 28, 1964, that rate became final, without objection or demand for hearing by Petitioner and other local service carriers.

The provision of the rate concerning the investment tax credit was, however, accepted most reluctantly and only because the alternative was to accept "open rate" status, which, as Respondent was well aware, was almost certain to produce considerably less subsidy than a closed rate.[22] A letter to Respondent on behalf of many of the carriers reflects this and is attached as Appendix A.[23]

It now appears that Respondent may again open the class rate to make further modifications and refinements in it. Respondent's staff has tentatively indicated a target date for a revised class rate of January 1, 1966. In

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[22] In first promulgating Class Rate I, Respondent acknowledged the many defects of the previous rate making practice which "resulted in extended open rate periods" and had "not enabled the carriers by and large to achieve reasonable earnings". 34 C.A.B. at 429-431. A lower rate of return (traditionally 7 percent) is paid for open rate periods. For such periods Respondent also makes hindsight expense disallowances on matters of management judgment—which is not true under closed rates. These disallowances have in the past accounted for the unreasonably low earnings described by Respondent.

[23] The carriers had requested Respondent to leave open the investment tax credit issue for judicial determination, but it refused to do so, stating:

> ". . . However, the carriers seek a departure from the traditional method of challenging rates proposed by the Board. They request that language be included in Class Rate III which would preserve for each carrier the right to challenge the tax provision in the courts at a later date, either in a special investment tax credit proceeding or after the provision is applied to the carrier in a future profit sharing determination under Class Rate III. We are of the opinion that granting the carriers' request would not be consistent with the Board's Rules of Practice nor with the concept of finality of rates. Accordingly, the request is denied." Order E-21227, Aug. 28, 1964, p. 36.

connection with the fixing of a new rate Respondent may again be expected to demand either acceptance of the entire rate, including the obnoxious provision authorizing it to deny the benefit of the tax credit, or a rejection of the rate *in toto*, with the consequent open rate status. Action by this Court on the question posed herein prior to January 1, 1966, would provide a judicial determination in time to avoid a repetition of the 1964 rate squeeze.

Respectfully submitted,

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Dated: September 30, 1965

APPENDIX A

September 17, 1964

Mr. Alan S. Boyd
Chairman
Civil Aeronautics Board
Washington, D.C.

Re: Class Rate III, Order E-21227
Docket No. 15359

Dear Mr. Chairman:

The undersigned carriers will not file a notice of objections to Order E-21227 in Docket No. 15359 proposing Class Rate III. However, we wish to advise the Board that the decision not to object reflects no concurrence by the carriers in the Board's action with regard to the investment tax credit. Our views were fully stated to the Board and its staff at a meeting on August 19, 1964.

As the Board is aware, because of the nature of the class rate it is not feasible for the carriers to risk prolonging a temporary rate status in order to litigate a single portion of the rate such as the investment tax credit question. However, we regret that the Board does not see fit to permit us to test the merits of the Board's holdings on this question in a formal proceeding before the Board without remaining on an open rate during the pendency of such proceeding.

Sincerely yours,

/s/ Cecil A. Beasley, Jr.
Cecil A. Beasley, Jr.
for Pacific Air Lines, Inc.,
Piedmont Airlines,
Southern Airways, Inc.

/s/ William Burt
William Burt
for Bonanza Airlines, Inc.

/s/ Albert F. Grisard
Albert F. Grisard
for Lake Central Airlines, Inc.

/s/ James M. Verner
James M. Verner
for Ozark Air Lines, Inc.
Trans-Texas Airways, Inc.

/s/ Harry A. Bowen
Harry A. Bowen
for Frontier Airlines, Inc

/s/ Edwin I. Colodny
Edwin I. Colodny
for Allegheny Airlines, Inc.

/s/ Raymond J. Rasenberger
Raymond J. Rasenberger
for North Central Airlines, Inc.

/s/ Robert W. Oliver
Robert W. Oliver
for Central Airlines, Inc.
Mohawk Airlines, Inc.